# INDEX





399371—56—— 1A

## APPENDIX B

AFFIDAVIT OF SIDNEY T. THOMAS, CHIEF, TAX AMORTIZATION BRANCH, CIVILIAN PRODUCTION ADMINISTRATION

CITY OF WASHINGTON, DISTRICT OF COLUMBIA, SS:

I, Sidney T. Thomas, being duly sworn, do hereby depose and say:

1. I am the duly appointed Chief of the Tax Amortization Branch of the Civilian Production Administration and prior to that was Acting Chief of said branch of the War Production Board since December 26, 1943.

2. In that position, I have been delegated authority by the Chairman of the War Production Board and his successor the Administrator of the Civilian Production Administration,[1] to consider applications for Necessity Certificates and to issue Necessity Certificates or to disapprove of such applications in accordance with the policies and regulations established by the Chairman of the War Production Board and the Administrator of the Civilian Production Administration under Section 124 of the Internal Revenue Code.

3. The statements made in this affidavit are based upon information received by me in my official capacity and which I believe to be true and accurate.

4. In order to give the necessary background of the tax amortization program, I quote from the Report of the then Under Secretary of War Robert P. Patterson to the Secretary of War dated 10 March 1945, copy

[1] The functions of the War Production Board were transferred to the Civilian Production Administration by Executive Order 9638 dated October 4, 1945.

of which is attached marked Exhibit A. As stated by Under Secretary of War Patterson:

> At the beginning of our rearmament program in 1940, industry was hesitant to accept contracts whose completion would require the use of private capital for creation of new facilities. Since we were not at war, and the future of the defense program hinged upon events and policies which could not be predicted with any certainty, industry could not ignore the possibility that conversions and expansions undertaken for defense purposes might not be kept in operation long enough to repay their cost, if the usual rate of amortization was employed. The hesitancy which this provoked was increased by two other factors, (1) the stringency with which the existing revenue laws treated facility costs in computing income, and (2) the prospect of greatly increased rates of taxation. Not only were these rates likely to increase, but no one could say exactly when or by how much.
>
> In the light of these uncertainties, the hesitancy of industry was understandable. At the same time, speedy plant expansion and conversion were vital military necessities. Something had to be done to reconcile financial prudence with urgent military need. To bring this about some assurance was needed that, in computing income, special allowance would be made for the possibility that war facilities would become useless before the expiration of their normal life. In view of the probability that earnings would be high for a brief period, and then might drop, it seemed only fair to permit the cost of the facilities to be taken out of the high income during the period in which it was being earned.
>
> In addition, there was every indication that Congress would provide a very high excess profits tax to cover the period of maximum earnings. This tax policy threatened to prevent a company accumulating enough surplus to

absorb the portion of the cost of the facilities which remained unabsorbed at the cessation of war production. Even patriotism could not reasonably be expected to include a contractor to court bankruptcy by tying up a large portion of his capital, much of it borrowed, in factory expansion which might suddenly become valueless. Some means had to be devised to allow the return of the cost of their expansion to the contractor while the expanded facilities were being used in war production.

On May 26, 1940, the President called upon private industry for help in rearmament and recognized that, in view of a possible curtailment of order within a year or two, private industry could not be expected to assume all the financial risks of this expansion. In a report of the Committee on Ways and Means of the House of Representatives on June 10, 1940 (Report No. 2491), made in connection with a revenue bill then under consideration, it was stated that proposals had been made to provide special amortization for national defense industries and to impose excess profits tax. The two proposals were to be considered as interdependent. A press release from the White House on July 10, 1940 announced that it had been decided to incorporate in the excess profits tax bill, which was soon to be introduced, a provision for amortization over a five-year period of national defense.

5. The passage of Section 124 of the Internal Revenue Code and its subsequent amendments then followed.

6. Many of the procedures and policies followed by the War Production Board in administering Section 124 were the necessary outgrowths of those established by the War and Navy Department during the primary administration of the law prior to December 17, 1943.

7. As required by the statute, the Secretaries of War and Navy issued from time to time regulations governing the issuance of Necessity Certificates. First, in time, was the regulation of May 22, 1942 approved by the President and later amended with the approval of the President on February 1, 1943. A copy of the regulation, as amended, is attached and marked Exhibit B.

8. During this period the purpose of the program was to get the plants built and devoted to war work in view of the great shortage of capital equipment to meet war needs. The guides to be followed in determining the issuance of Necessity Certificates included such factors as the type of supplies to be manufactured, the time of acquisition, whether in fact a definite shortage of capacity in plant existed, the purpose of the acquisition and related matters.

9. By the spring of 1943, as stated by the Under Secretary of War Patterson in his report:

> It was becoming apparent that the chief limiting factor in the production of war supplies no longer was facility capacity but materials and manpower. The search for maximum war production now required, not an encouragement of facility expansion, but a curbing of it. On May 12, 1943 the War Production Board publicly announced:
>
> With the exception of certain special programs, some special machinery, and further expansion of raw materials production, the United States at last has the machine tools and the capital equipment it needs to build production to defeat the Axis. For the first time in its history, the nation now has a physical plant adequate to make the maximum use of its resources in men, skill and materials.
>
> An examination of our production effort up to that point revealed that the nation had de-

voted almost as much effort to the construction of necessary facilities as it had to the actual production of arms and munitions. Thereafter, it was believed, the greater part of the plants and materials which had been used so far in making machinery and equipment ought to be devoted directly to manufacturing planes, guns, tanks, and other munitions. It was suggested, therefore, that steps be taken either to restrict certification very rigidly, or to terminate it entirely.

10. We were entering into a phase of total warfare under which materials and manpower were short and every facet of our economy was being affected. It would seem that no investment of capital should be made and no one should be allowed to use materials unless the facilities involved were clearly "necessary in the interest of national defense". If mass certifications were granted, the resultant loss of revenue to the Treasury would be appreciable. With increased tax rates, Necessity Certificates had become more attractive as a method of financing than they were when the statute was originally enacted. The cost to the Government of certified facilities was higher through a sacrifice in tax revenues. For these reasons, among others, the entire matter was re-examined with a view to determining whether the Act should be terminated so far as giving further amortization rights to any facilities or whether any investment of private capital should be entitled to emergency amortization.

11. On June 25, 1943, the matter was submitted to the Office of War Mobilization, with a suggestion of possible alternatives. The Director of War Mobilization, after considering the matter, directed the War and Navy Departments to amend the regulations governing the issuance of necessity certificates. It was suggested that the issuance of certificates for facilities

for a military or naval supply might still be authorized in exceptional and limited cases where the need had been determined before expansion.

12. Therefore, an amendment to the existing regulations was submitted to the President for approval. This amendment to the Regulations was approved by the President on October 5, 1943 (8 F. R. 13824). A copy is attached and marked Exhibit C. Out of fairness to the applicant who had already spent his money or who had previously filed his application, the discontinuance was not to apply retroactively

The amendment provided that a facility "shall not be deemed necessary" unless either Secretary, in exceptional cases, has determined prior to the beginning of construction or the date of acquisition that there is a shortage of facilities for a supply required for military or naval use and that it is to the advantage of the Government that additional facilities for such supply be privately financed. As has been indicated, the clear intention was to obtain substantial termination of the issuance of certificates. For that reason, the press release issued on the date when the President approved the regulations stated that the amendment "indicates virtual termination of the tax amortization privilege". (See NY Times, Oct. 10, 1943, Sec. 5, P. 59, Col. 1; NY Times, Dec. 19, 1943, Sec. 5, P. 10S, Col. 5.)

13. In addition to the extensive notoriety of the amendment given in the press of the country, and its publication in the Federal Register, a copy of this amendment was sent to all taxpayers, including the plaintiff United States Graphite Company, who had previously filed application for necessity certificates. Copy of this notice is attached and marked Exhibit D.

14. On December 17, 1943, the President, by Executive Order, (No. 9406, 8 F. R. 16955) transferred the

function of issuing necessity certificates in all future cases from the Secretary of War and the Secretary of the Navy to the Chairman of the War Production Board. The War and Navy Departments, however, were to decide the applications then on file. The principle of predetermination and the principle of considering what was to the advantage of the Government as a financial matter were retained in the transfer. On the same date, the President approved the amended regulations governing the issuance of necessity certificates prescribed by the Chairman of the War Production Board. Copies of these regulations are attached hereto and marked Exhibit E.

15. The new regulations adopting the principles outlined in the regulations of the Secretaries of War and Navy recognized the complete tie-in between the actions taken in granting priorities or authorization to construct with respect to facilities and the financial matters to be decided with respect to the issuance of necessity certificates. Regulation (3) (c) (v) required that an application for necessity certificate be filed concurrently with the request for priority assistance or specific authorization.

16. With respect to future certifications, the Executive Order specified that necessity certificates should not be issued unless prior to the beginning of construction or date of acquisition, the Chairman of the War Production Board determined (1) that the facilities were clearly necessary for the war effort, and (2) that it was to the advantage of the Government that the facilities be privately financed.

17. It should be noted in this connection that the granting of priorities called for different considerations and the application of different standards than those entering into the issuance of necessity certificates. The power to grant priorities was derived from

an entirely separate law (The Second War Power Act) and was administered under different Executive Orders No. 9040 (7 F. R. 527); No. 9125 (7 F. R. 2719); No. 9638 (10 F. R. 12591). In point of fact, the preference ratings issued to United States Graphite Company in this case for this equipment were AA–3. There were several priorities higher than this that could have been granted.

18. There was a tremendous advantage to be gained by any private manufacturer who could build up a postwar plant at the expense of wartime income. A memorandum prepared by the Tax Amortization Branch of the War Production Board outlining the factors to be considered in predetermination, whether it was to the advantage of the Government that the facilities be privately financed, is attached and marked Exhibit F. The standards applied in the partial certification of facilities were these:

1. Postwar utility

A. Under War Production Board policy, facilities having presumptive postwar utility receive partial certification only. This policy arises out of section 3-b-2 of Executive Order 9406 which requires a finding: "that it is to the advantage of the Government that such additional facilities be privately financed." The section was designed to protect the financial interest of all of the taxpayers in a certified facility. The Government, which represents all the taxpayers, may eventually pay as much as 85 percent of the cost of a fully certified facility, whereas if the facility were Government owned, the Government would be able, by sale or other disposition after the war, to recoup a part of its cost. Thus, the facility would have been made available for the war effort at a probable saving as compared with full certification. The saving would result no matter who is able to use the facility after

the war, so that postwar utility should not be considered as limited to utility in the hands of any particular applicant.

B. Postwar utility is not restricted to usefulness to the applicant himself in his regular business, as a facility is considered to have presumptive postwar utility if it may reasonably be considered useful to anyone after the war. For example, a "standard machine tool" is always considered to have postwar utility because it can be used to produce many items other than the subject war product for which the applicant needs it. On the other hand, a "special machine tool" which can be used only to make a specific war product having no civilian use would be considered as having little or no presumptive postwar utility. Again, permanent structures, installations, and building additions are practically always to be considered as having presumptive postwar utility, while a strictly temporary structure of such construction that it could not be useful for many years might be considered to have little or no presumptive postwar utility.

II. Purpose of partial certification

Partial certification is intended to cover a liberal allowance for the excess cost of wartime acquisition or construction as compared with normal or prewar (1937–1939) costs.

III. Standard 35 per cent partial certification

A. After surveys of current and prewar costs of many types of facilities, partial certification has been standardized at 35 per cent of current costs.

B. Departure from the standard 35 per cent partial certification for facilities having presumptive postwar utility would require definite evidence that 35 per cent does not cover the increase in current costs above prewar costs. For example, if it be established that a

facility currently costing $100,000 could have been built in the period 1937–39 for $40,000, a recommendation of 60 per cent certification would be in order.

IV. Mixed percentage certification

There is no objection to recommending 100 per cent certification of certain facilities and denial or partial certification of certain other facilities covered by the same application, or a mixture of all three recommendations, as the facts may warrant. Such mixed percentage recommendations should clearly indicate which recommendation applies to each portion of the application, and the reasons therefor.

V. Recommendations

All recommendations should specify whether or not the facility is considered to have postwar utility. If special circumstances appear to warrant certification in excess of the standard 35 per cent, the facts should be clearly stated to support an appropriate recommendation.

19. There is attached hereto a copy of the circular dated March 8, 1944 approved by J. A. Krug, then Vice Chairman of the War Production Board, setting forth criteria for preparation of recommendations for necessity certificates. A copy is attached and marked Exhibit G.

20. Under the above established procedures, the application of the United States Graphite Company for a necessity certificate to amortize its machinery was considered. This application was filed on May 29, 1944, with the Tax Amortization Branch of the War Production Board. This application was considered independently of the issuance of a necessity certificate for the plant. The necessity for amortization of the machinery was determined upon the facts and circumstances then existing at the time of the

application. The bulk of the machinery in question consisted of standard machine tools in general use in industry such as internal grinders, drill presses, surface grinders, hydraulic grinders and related tools. It was our opinion that these items were likely to have a broad market and general value at the end of the war and be of use for normal peacetime production.

21. Applying the general principles and policies outlined in the regulations, we arrived at the determination that only 35 per cent of the cost of these items should be amortized during the emergency period. Accordingly, a necessity certificate was issued for the items acquired after the time of our determination, July 17, 1944, covering 35 per cent of the cost. Items acquired before that date were denied a necessity certificate for the reason that the application was not filed at the time required by the regulation.

22. The scope of this program is indicated by the fact that total dollar value of necessity certificates issued since the inception of the program in 1940 exceeds $6,700,000,000. Applications and certificates covered every phase of industry, manufacture, mining and transportation. Subsequent to the transfer of this program to the Chairman of the War Production Board on December 17, 1943, a total of 11,435 applications for necessity certificates were received and passed on by the War Production Board. Of these, 2,074 were approved, 4,268 were denied in part, 3,671 were denied in total, and 1,422 were withdrawn. In approximate dollar value, the total amount covered by applications for necessity certificates during this period was $1,498,730,000. Of time amount, $70,-163,000 were approved and the total amount denied was $797,567,000.

23. Although accurate statistics are not available covering the exact percentages of such applications which were denied for various reasons, of the total amount of all certificates issued, a majority were granted for only a percentage of the amount applied for, varying in individual cases from 20 per cent to 80 per cent, dependent upon the determination of what portion of the material applied for were attributable to expenditures necessary in the interests of national defense during the emergency period. A substantial portion of the applications were denied, in whole or in part, for the reasons that application was not made in a timely manner as provided by Executive Order No. 9406 of December 17, 1943, and the regulations of the War Production Board.

24. The administration of Section 124 involved difficult and intricate problems. As put by Under Secretary of War Patterson:

> Danger came from two directions. On one side, the law had to be administered so as to make it possible for the manufacturer actually to secure the protection it was designed to provide and to secure it so promptly that he would begin work at once. On the other hand, the Government had to be protected against any action under the law which might confer upon firms using it, advantages beyond those legitimate and necessary to the enlisting of their cooperation in building defense facilities. Under the special circumstances which existed between the Fall of France and Pearl Harbor, a belief that the Tax Amortization Law was being used as a means to gain undeserved profits might have reacted disastrously upon the whole defense program.

25. The whole philosophy of the program was an attempt "to map a careful course which would secure

haste without waste". The determination of the application of the United States Graphite Company conformed to these principles.

Attachments.

SIDNEY T. THOMAS.

Sworn and subscribed before me this 27th day of December, 1946.

MARY M. REPETTI
*Notary Public, D. C.*

My commission expires Dec. 1, 1949.

EXHIBIT A

Filed Dec 30 1946—C. A. 36695

WAR DEPARTMENT

OFFICE OF THE UNDER SECRETARY

WASHINGTON, D. C.

## A REPORT TO THE SECRETARY OF WAR ON THE ADMINISTRATION OF SECTION 124 OF THE INTERNAL REVENUE LAW RELATING TO THE ISSUE OF NECESSITY CERTIFICATES.

### INTRODUCTION

Wars are often lost before the first shot is fired.

Fortunately enough Americans realized this back in 1940. Although the national peril was great, we were not at war. We were witnessing the tragic consequences of "too little and too late." Our Army was woefully small, and we were totally lacking in facilities capable of producing the vast quantities of munitions that would be required. Immediate action was needed to avert the fate of other unprepared nations.

Congress passed laws to get the men it knew we would need for our armed forces and to get the material with which to arm them. The Selective Training and Service Act was passed in September 1940 to get the men. The Tax Amortization law was passed in October 1940 to help get the material.

Private industry was naturally reluctant to risk its funds in the creation of war facilities. The Tax Amortization law was designed by Congress to give industry protection against possible bankruptcy and to encourage it to use its capital in building war facilities. The law did this by allowing a write-off of the cost of the facilities within a period of five years.

This measure enabled us as a Nation to rely upon private industry for part of the needed expansion. It gave us the opportunity to build with speed the necessary facilities, not only to defend our shores but to attack the enemy without let-up.

The attached report shows how the law, by no means perfect as it was first written, was amended to become more efficient step by step. It shows how the problems of administering it, unexpected in their extent and complexity, were tackled and solved. It outlines a few of these problems.

The need for huge quantities of tanks, planes and guns was evident at the start. But for tanks, we needed steel; for steel, we needed coke; for coke, we needed coal; for coal we needed transportation. New facilities were needed to produce an enormous variety of items needed for the war ranging from alpha protein to fish oils, from igloos to synthetic rubber, from V-mail to yeast. The total of facilities certified by the War Department had a value of almost five billion dollars.

Certification had to be speedy, but it also had to be carefully administered so that the Government's inter-

est would be protected. Infinite care and careful attention to details were essential in meeting the many unprecedented situations which arose. The distinction between facilities necessary for defense purposes and those which were not, was often difficult to make. There was no doubt that a machine gun plant ought to be certified, and relatively little doubt that movie theatres and facilities for providing soft drinks, candies and pies for war workers ought not to be certified. But there were cases in between these extremes, such as facilities for housing, for banks and for servicing firms, where a correct decision as to the applicability of the law involved perplexities. Mistakes were doubtless made, but an important job was well done.

A pattern has here been written of how legislation designed to solve a technical and difficult problem can be put into action—perfected as it goes along—and, through intelligent administration, made to achieve notable success.

It is one chapter in the record of how this Nation, operating within a system of private enterprise which our enemies sneered at as stupid and inefficient, was able to arm itself with greater speed and thoroughness than any other Nation in history.

ROBERT P. PATTERSON
*Under Secretary of War*

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WAR DEPARTMENT

OFFICE OF THE UNDER SECRETARY

WASHINGTON, D. C.

February 15, 1945

# A REPORT TO THE SECRETARY OF WAR ON THE ADMINISTRATION OF SECTION 124 OF THE INTERNAL REVENUE LAW RELATING TO THE ISSUE OF NECESSITY CERTIFICATES.

## The Need for the Amortization Law

At the beginning of our rearmament program in 1940, industry was hesitant to accept contracts whose completion would require the use of private capital for creation of new facilities. Since we were not at war, and the future of the defense program hinged upon events and policies which could not be predicted with any certainty, industry could not ignore the possibility that conversions and expansions undertaken for defense purposes might not be kept in operation long enough to repay their cost, if the usual rate of amortization was employed. The hesitancy which this provoked was increased by two other factors, (1) the stringency with which the existing revenue laws treated facility costs in computing income, and (2) the prospect of greatly increased rates of taxation. Not only were these rates likely to increase, but no one could say exactly when or by how much.

In the light of these uncertainties, the hesitancy of industry was understandable. At the same time, speedy plant expansion and conversion were vital military necessities. Something had to be done to reconcile financial prudence with urgent military

need. To bring this about some assurance was needed that, in computing income, special allowance would be made for the possibility that war facilities would become useless before the expiration of their normal life. In view of the probability that earnings would be high for a brief period, and then might drop, it seemed only fair to permit the cost of the facilities to be taken out of the high income during the period in which it was being earned.

In addition to the difficulties already mentioned, prospective contractors also had to take into account the existence of a tax law designed to limit profits. This was the Vinson-Trammel Act which had originally limited profits on naval and aircraft construction to 12%, but which was amended, at exactly the moment when a great facilities expansion became necessary, to limit profits to 8%. In addition, there was every indication that Congress would provide a very high excess profits tax to cover the period of maximum earnings. This tax policy threatened to prevent a company accumulating enough surplus to absorb the portion of the cost of the facilities which remained unabsorbed at the cessation of war production. Even patriotism could not reasonably be expected to induce a contractor to court bankruptcy by tying up a large portion of his capital, much of it borrowed, in factory expansion which might suddenly become valueless. Some means had to be devised to allow the return to [of?] the cost of their expansion to the contractor while the expanded facilities were being used in war production.

The Treasury took the position that, under existing law, the depreciation period could not be accelerated. It could give no assurance of a deduction for partial loss of useful value which, as soon as the emergency was over, would have allowed the writing

down of the facilities to their post-war value. This inability to offer the contractor any assurance of special treatment of his war facilities for tax purposes made industry hesitate seriously about executing contracts for rearmament. The defense program was thus placed in serious jeopardy.

On May 26, 1940, the President called upon private industry for help in rearmament and recognized that, in view of a possible curtailment of orders within a year or two, private industry could not be expected to assume all the financial risks of this expansion. In a report of the Committee on Ways and Means of the House of Representatives on June 10, 1940 (Report No. 2491) made in connection with a revenue bill then under consideration, it was stated that proposals had been made to provide special amortization for national defense industries and to impose excess profits tax. The two proposals were to be considered as interdependent. A press release from the White House on July 10, 1940 announced that it had been decided to incorporate in the excess profits tax bill, which was soon to be introduced, a provision for amortization over a five-year period for new facilities certified as necessary for the purpose of national defense. The announcement stated:

The contemplated action is expected not only to simplify the multiple tax problems of prospective contractors but to greatly clarify their future tax liabilities.

In this manner any doubts as to the tax position of contractors in the general program of national rearmament will be removed and they will be able quickly to execute defense contracts.

World War I Law. There had been an amortization law for World War I but it was not considered a useful model. It had not been passed until three months after the Armistice; it provided for amortization on the basis of loss of useful value, an intangible factor which was to be determined by the courts. Consequent litigation had dragged on for years.

Basis for new law. In order to provide a law susceptible of exact calculation, it was decided that the new amortization provision should be based upon depreciation rather than loss of useful value. In other words, deduction of the entire cost of new defense plants was to be permitted during the period in which orders for war material continued. Because it was recognized that it was nearly impossible to determine in advance what facilities would be useful, and how far they would be useful, when war orders ceased, it was decided to permit the charging off of the entire cost, or a predetermined percentage thereof. Because it was also impossible to know in advance how long the facilities would be engaged on war work, the tentative amortization period was fixed at five years, with provision for shortening the period and accelerating amortization correspondingly, with proper readjustment of the tax, if war orders did not require the use of the facilities for the full period of five years.

In order to provide a law susceptible of speedy administration, it was concluded that decisions as to necessity should be made not by the courts but by the procuring agencies, which could be expected to know best whether a particular expansion was necessary to national defense.

Introduction of bill. Provisions for amortization were incorporated in the bill, H. R. 10413, together

with provisions for imposing an excess profits tax and for suspending the profit-limiting provisions of the Vinson-Trammel Act during the period in which the excess profits tax was in effect.

The Assistant Secretary of the Treasury, in explaining the bill, stated that the existing provisions for depreciation were designed to allow the cost of facilities as deductions from income during the years in which the asset contributed to income, but he recognized the inadequacy of these existing provisions when applied to facilities for the defense program.

Following the joint hearings of the Ways and Means Committee and the Senate Finance Committee, which consumed five days, H. R. 10413 was introduced in the House on August 27, 1940 and was passed without amendment on August 29.

Conditions in granting of amortization—Subsection (1). Objection was raised in the Senate to three subsections of the amortization provisions of the bill passed by the House. These subsections, (l), (j), and (k), incorporated a policy designed to insure the continued existence of the amortized facilities for possible further use in national defense. To provide for this it was stipulated, under penalty of an increased tax liability, that the facilities for which amortization deductions were taken were not to be destroyed or substantially altered without the consent in writing of the Secretary of War or the Secretary of the Navy. If consent was refused the Government was obligated to purchase the facilities at a price not in excess of the adjusted base nor less than one dollar, with provision for repurchase by the taxpayer under certain circumstances.

The Advisory Commission to the Council of National Defense asked for the elimination of these three subsections. The Commission expressed full approval of

their purpose but believed the objective could best be accomplished through contract provisions. In this connection the Advisory Commission outlined a contracting policy which it believed would adequately protect the interest of the Government in facilities which were accorded amortization.

The Finance Committee, after concluding its hearings, reported the bill back to the Senate with amendments. The principal amendment was a substitute subsection (i) to take the place of subsections (i), (j), and (k). The new subsection (i) required, in the alternative, either "non-reimbursement" or "government protection" as a condition to amortization. The Senate passed the bill as thus modified, and in conference the substitute subsection (i) was agreed upon.

Certificates Contemplated by Act. The Act, was finally approved on October 8, 1940 (Public Law 801, 76th Congress; Section 124 Internal Revenue Code) provided as follows:

Necessity Certificate. For facilities acquired or constructed after June 10, 1940,[1] which the Advisory Commission and either the Secretary of War or the Secretary of the Navy by the issuance of a "Necessity Certificate" certified were necessary in the interest of national defense, an annual deduction of 20% of the cost could be taken at the election of the taxpayer. Thus, these facilities could be amortized in five years.

Certificates of Non-Reimbursement and Government Protection. By the terms of subsection (i), the amor-

[1] This date was agreed upon in conference, it being the date upon which the House Ways and Means Committee reported its intention to consider an amortization act. It was thought that a decision to build or acquire facilities after that date might be assumed to have been made with a promise of amortization. The original draft had fixed upon the date of the White House release, July 10, 1940.

tization deduction was allowed only upon condition that the contract offered no direct or indirect reimbursement in excess of normal exhaustion, wear and tear, unless the contract which afforded such reimbursement also contained terms which adequately protected the interest of the United States Government in the future use and disposition of the facility. The fact that no reimbursement had been offered in a particular contract could be established, with respect to any given contract, by a Certificate of Non-Reimbursement issued jointly by the Advisory Commission and either the War or Navy Departments. The fact that the contract adequately protected the interests of the government could be established by a Certificate of Government Protection, similarly issued.

Non-Necessity Certificate. If before the expiration of the five-year period the Secretary of War or the Secretary of the Navy certified by issuance of a "Non-Necessity Certificate" that particular facilities had ceased to be necessary, provision was made, at the taxpayer's option, to recompute the amortization deduction so as to provide full amortization over the shortened period. A similar privilege was given, without issuance of a certificate, to all owners of certified facilities if the President proclaimed that a substantial portion of the certified facilities had ceased to be necessary. Taxes were to be recomputed in accordance with the recomputed amortization.

Payment Certificate. The Act also provided for certification by the Secretary of War or the Secretary of the Navy of the fact of payment in cases where a payment was made for unamortized costs because the contract involving the use of the facilities had been terminated by its terms or by cancellation, or in cases where a contemplated contract involving the use of the facilities was not granted. In such cases amortization

was to be accelerated, at the election of the taxpayer, by permitting a larger deduction for the year of the payment.

### Amendments of the Law

Filing Date. As passed on October 8, 1940, the amortization law provided that Necessity Certificates should not be issued unless issued before the beginning of the construction or the date of acquisition; except that in the case of facilities already started or acquired when the law was passed, the certificate had to be issued before February 6, 1941. This time limit for the issuance of a certificate, regardless of the time of filing the application, afforded no opportunity for investigation and made the statute impossible to administer. As the February 6 deadline approached, the necessity for legislative change became obvious. The matter was laid before Congress, and on January 31, 1941, Public Law No. 3, 77th Congress (H. J. Res. 80), was passed amending the law so as to eliminate the fixed date and provide instead that an application for a necessity certificate must be filed within 60 days of the beginning of construction or of the date of acquisition or before February 6, 1941.

Although this provided ample time for the proper consideration of cases, it was found by late spring that the continually growing demand for war material caused such frequent changes in plans for facilities that the time limit of 60 days for the filing of applications was unsatisfactory. The War and Navy Departments accordingly proposed to Congress on July 30, 1941, that the law be amended to extend to six months the period in which applications must be filed. This, it was hoped, would make it possible to gather in one application proposals which had previously appeared in two or more. The amendment, together

with others described below, were passed by Congress. The President gave his approval to it as Public Law 285, 77th Congress (H. J. Res. 235), on October 30, 1941.

Joint Certification. The requirement of joint certification by two governmental authorities had all the disadvantages of divided responsibility. Administrative history in the past had often proved the unwisdom of such an arrangement; experience with the Amortization Law proved it once more. While the War and Navy Departments had agreed with the Advisory Commission of the Council of National Defense on instructions for the preparation of applications early in November of 1940, agreement on general principles for deciding cases was not achieved. Particular difficulty was encountered with respect to Certificates of Non-Reimbursement and Government Protection. Every attempt was made on both sides to be judicial, but agreement was not achieved. Since there was no machinery for appeal, deadlocks were inevitable and delays in administration became sufficiently serious to give contractors just cause for concern. A change in the law was necessary. The Armed Services urged that they be relieved of responsibility or given sole responsibility. By the fall of 1941, the Advisory Commission had practically no active functions other than that of certifying orders under the Amortization Law. The Armed Services, being the procuring agencies, were in the best position to decide the facility needs of their procurement programs. Once convinced that joint certification was a failure, Congress had little hesitation in terminating the Advisory Commission's certifying authority. This was done on October 30, 1941. From then on, War Department cases were decided by the War Department alone and Navy cases decided by the Navy alone. In due course of time,

both agencies came to lean heavily upon the able assistance of the War Production Board in matters involving civilian supply.

**Non-Reimbursement and Government Protection.** Because sub-section (i) of the basic law required certification that there had been no reimbursement or in the alternative that there had been government protection, every contract, even those for small amounts of standard supplies, had to be examined. In the absence of either a Certificate of Non-Reimbursement or a Certificate of Government Protection, no assurance could be given the contractor that he would be entitled to amortization under his Necessity Certificate.

Determination of whether or not the price included reimbursement for more than normal depreciation proved almost impossible of attainment.

It was also difficult to establish standards for protection of the government's interest in amortizable facilities. An attempt was made to arrive at a uniform contract provision to be inserted in all supply contracts involving additional facilities, which would adequately protect the interest of the United States in the future use of disposition of the facilities and would legally warrant the issuance of a Certificate of Government Protection. However, the Attorney General gave his approval only to provisions which proved unworkable from a practical standpoint.

Some relief was secured by the October 30, 1941 amendment to the law (Public Law 285) whereby contracts under $15,000 and contracts for non-defense supplies were excluded from examination for reimbursement of facility costs. But there still remained the apparently insuperable difficulty of deciding whether the unit price in the numerous larger contracts included an amount in excess of normal depreciation. The amortization law was intended to over-

come the hesitancy of contractors to invest private funds in needed facilities. To do this effectively the necessary certificates had to be issued at approximately the time of contracting for the facilities. By the end of 1941 Necessity Certificates had been issued by the War Department on $1,210,700,000 of facilities but the record on Certificates on Non-Reimbursement and on Government Protection was unsatisfactory. 3,120 applications had been made to the War Department for certificates of Non-Reimbursement; only 278 had been issued. 219 applications had been received for Certificate of Government Protection; only 30 had been issued. Delay was causing considerable doubt about the amortization allowance. Hesitancy on the part of prospective contractors continued.

This was the situation when the United States was attacked by Japan. In spite of the gathering danger, the flow of private capital into plant expansions had not been rapid. And although a vast amount of Government financing had been provided, the tremendous demands which the coming war set up made it highly desirable to afford private capital an adequate opportunity to serve.

On December 17, 1941, the War and Navy Departments proposed to Congress the repeal of subsection (i) as of the date of its passage. They took the position that the protection of the interest of the Government could be assured by a sound contracting policy at the time the contract was agreed upon. By that time the War Department had gained a great deal of experience with the problems involved in contracting for supplies requiring new or additional facilities. In view of the grave situation created by the outbreak of war, and the urgent need for making the greatest practicable use of private financing, it seemed only reasonable to rely upon this experience,

rather than rigid rules, in administering the Amortization Act.

On February 5, 1942, H. J. Res. 257 (Public Law 436) which repealed subsection (i) as of the date of its passage was approved. With its passage the major obstacle in administering the Amortization Act was removed.

Further Amendments.

Under the original act only corporations were allowed amortization deductions. Although never clearly stated, it was understood that this limitation sprang from the fact that only corporations were liable to the excess profits tax. From time to time the question was raised whether individuals or partnerships, operating as such ought not to be included. As a consequence, in the Revenue Act of 1942, the Treasury Department suggested the extension of amortization to individuals and partnerships and the law was so amended by Public Law No. 753, 79th Congress. This same Act also permitted, for the first time, amortization of facilities acquired prior to June 10, 1940, the earliest permissible date of acquisition being extended back to January 1, 1940. The War Department neither offered nor expressly favored these amendments.

## Administration by the War Department

Delegation to Under Secretary. On October 15, 1940, one week after the passage of the Amortization Law, the Secretary of War delegated to the then Assistant Secretary of War (later Under Secretary of War) the duty of considering and acting upon the certificates which the Act required the Secretary of War to issue.

Organization of Tax Amortization Unit. A unit was established in the Office of the Assistant Secre-

tary of War to administer the Act and to advise the Assistant Secretary as to the action to be taken upon applications. It was not formalized until Mr. Samuel Duryee became its Chief in December 1940. Lt. Colonel (now Brig. General) Edward S. Greenbaum took over as acting Chief in March 1941 and carried that responsibility along with his other duties until January 1942. Lt. Colonel (now Colonel) George H. Foster then became Chief and held that position until the work was completed in 1944. The entire staff including military and civilian personnel was never more than 80 persons at any one time. Although this unit with its personnel and records has been transferred to different Divisions of the War Department, it has continued since its inception to administer the law under, and has remained responsible to the Under Secretary. All policy matters were settled in consultation with him and each certificate granted or denied received his approval.

Appointment of Advisory Board. In April, 1941, the Under Secretary appointed an advisory board, composed of men prominent in civil life, to examine applications for amortization with particular reference to the issuance of Certificates of Non-Reimbursement. These men gave generously of their time and experience and greatly aided the War Department in its effort to solve these difficult problems. The Board was composed of:

James P. Baxter, 3rd, President, Williams College, Massachusetts

Samuel S. Duryee, Attorney, New York City

W. Tudor Gardiner, Former Governor of Maine

Garrard Glenn, Professor of Law, University of Virginia

James Hall, C. P. A., New York City

F. H. Hurdman, C. P. A., New York City

Bernard Knollenberg, Librarian, Yale University, Connecticut

James M. Landis, Dean, Harvard Law School

Harold F. Linder, Retired, New York City

William L. Marbury, Lawyer, Baltimore, Maryland

Abbot P. Mills, Attorney, Washington, D. C.

Dave H. Morris, Jr., Banker, New York City

Charles H. Murchison, Attorney, Jacksonville, Florida

George S. Olive, C. P. A., Indianapolis, Indiana

Frederick F. Umhey, Executive Secretary, International Ladies Garment Workers Union, New York City.

(David Dubinsky, President of the International Ladies Garment Workers Union, was originally appointed, but at his request Mr. Umhey was appointed in his place.)

With the repeal of the non-reimbursement and government protection provisions of the law, the principal duties of the Board ceased. However, the aid of individual members was from time to time obtained in deciding the more difficult questions relating to necessity certificate applications. In the Spring of 1942, a working committee of three was formed, composed of Mr. Hall, Mr. Umhey and Professor Glenn (who was later forced to withdraw because of ill health). They made regular trips to Washington in order to advise on policies or specific cases and preside over hearings with applicants. Their work was of material assistance to the War Department.

Regulations. War Department interpretation of the law was based upon Regulations governing the issuance of Necessity Certificates, drawn up by a three-man Committee consisting of representatives of the War Department, Navy and War Production Board, and approved by the President May 22, 1942.

The regulations set no hard and fast rules except as to purely procedural matters such as timeliness of filing. The guides to be followed in determining necessity were quite simple and can be briefly summarized as follows. The necessity of a facility was to be determined in accordance with whether the supply it produced was required in the interest of national defense. A supply might be so required if essential to the armed forces, to any foreign nation furnished supplies under an act of Congress, or, under certain circumstances, even if it had only civilian use. Shortage of capacity in the industry must ordinarily be shown in order to justify an expansion.

Shortage of Capacity. The basic reason for insisting on a showing of shortage of capacity, rather than to increase the capacity of a particular company to meet its contract requirements, was the desire to spread contracts more evenly among all portions of an industry capable of producing the required items. Although generally successful in helping to spread the work, this policy necessarily required the denial of applications in cases where other companies possessed idle facilities capable of producing the needed items. When, at a later date, war production had to be doubled and trebled, the resulting shortage in capacity compelled the reconsideration of these original denials.

Types of Supplies. In the beginning it was evident that tanks, planes, guns, and ships would be demanded in quantities far beyond the existing fabricating capacity of the country. Shortly it became apparent that additional basic steel capacity was necessary. This in turn required more coke ovens for coke, more coal for coke, more iron ore, hence more mining facilities, and more transportation facilities to move the ore, coal, coke, and steel to places of usefulness. Workmen had to be transported to and from work, or

housed at places of employment. Applications for the certification of transportation facilities and war housing were presented for decesion. At many plants the rapid expansion of personnel led to the inauguration of "in-plant feeding." This brought applications for cafeteria facilities in the plants. A few of the items which were at one time or another determined to be necessary on the particular facts of the case, picked entirely at random, may be listed to give some idea of their great variety:

alpha protein, aircraft antenna, anti-toxins, arsenicals, balloon barrage wiring, balloon cloth, blitz cans, box shook, commercial alcohol, cotton duck, cord, cuspidors, dehydrated foods, dyes, ether, felt, fire extinguishers, fish oils, glue, gun butts, gun stocks, hard chrome plating, igloos, insulation materials, jeans, jungle boots, lenses, life preservers, lime, nicotinic acid, parachutes, paulins, pliers, plywood, pigments, ponderosa pine, poplins, prisms, remote control systems, resin coated raincoats, safety belts, shearlings, slide rules, soluble coffee, steel casings, steel tubing, sulpha drugs, surgical dressings, synthetic rubber, synthetic sapphire, tallow, tin plating, tuads, V-mail, water purification machines, webbing, wire cutters, wrenches, and yeast.

Other Factors. In addition to the specific legal and administrative problems governing amortization, it was necessary to take into account broad problems of contract distribution, priorities, price control, and many other factors affecting the transfer from a peace to a war economy. In determining the need for facilities it was necessary, not only to consider contract commitments and future demands related thereto, but to place the request for certification in its proper place in the over-all picture of expansion, priorities, contract distribution, and other problems and policies.

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When a decision on a particular case was finally made, it represented an investigation of the industrial consequences which might spring from it. As the country approached an all-out war effort it became more and more difficult to decide where to draw the line. Although some general trends of procedure might be traced, the policy was predominantly one of judging each case on its merits.

Relation to National Defense. Certain facilities were obviously too far removed from the war to be certifiable. New construction of an office building in a large city was denied even though there was indication that its construction would ultimately be of indirect benefit to the defense program. And even though the Office of the Petroleum Co-ordinator requested wholesale conversion of oil burners to coal burners, such conversion was not certified where the applicant's product was not necessary. Applications related to such services as engineering were denied (the product of engineering firms being denominated as intellectual rather than physical) as were those related to retail distribution.

Time of Expansion. The decision as to necessity was made as of the time of expansion or later certification. In some cases the application was not received until after the facility was no longer necessary. Certain expansions of the natural rubber fabricating industry, of tin fabrication and of toluene processing (to use South American oil) were started and thereafter proved ineffective due to the situation arising after Pearl Harbor. However, amortization was granted because the facilities had been necessary when constructed.

Items Unnecessary for Defense Purposes. On occasion, an applicant was allowed certification of a larger facility than it actually needed if there was con-

vincing evidence that no smaller facility was available. A company purchased "the only location we could get" which was "probably a third more than our requirements." Certification was granted on evidence that the useful part of the land was necessary and none other available. But where shortage of building space resulted from the fact that the applicant was building for permanence with comparative luxury, certification of a new building was denied. For the War Department was careful not to certify facilities which were in the luxury class. Plants to produce soft drinks and pies in this country were denied, as were bottled drink and candy trucks and vending machines. Certification was denied for electric signs, glass desk tops, fish ponds, ping pong tables, pool tables and soda fountains. A flag pole was considered certifiable. Expensive carpets were denied. (But where the applicant's business involved use of diamonds, often dropped on the floor, a carpet was certified.) Air conditioning was ordinarily denied as a luxury; certified where necessary for precision work or for other extraordinary reasons. While facilities for employees were in general allowed, the expansion of a bank to accommodate defense workers and soldiers was denied, as was a shopping unit to be built in connection with a housing project consisting of a restaurant, recreation building, doctors' and dentists' offices, movie theatre, drug store, etc. Couches were on occasion denied, yet where a shift was made from male to female labor and heat prostration was a frequent occurrence in a plant, they were obviously necessary and they were certified.

Costs: Derivation of Funds: Reconversion. The cost of a facility was in general considered a matter in the discretion of the applicant so that if the facility was appropriate and necessary, inquiry was not made as

to whether it was purchased or constructed for the lowest possible price or cheapest type of construction. Nor was inquiry made of the source of the funds from which the purchase was made. A new plant was about to be constructed following condemnation of an older plant; presumably it was financed with funds received from the condemnation; the application was certified. The cost of conversion from peacetime to war use was certified, but no certificate granted for an allowance in order to reconvert to peacetime use after the war.

Acquisition of Leased Property. Many applications were received for purchase of formerly leased property. In these cases, careful inquiry was made as to whether the purchase was actually necessary or whether it was feasible for the applicant to continue to lease; if the latter was the case, certification was refused.

Acquisition from Related Persons. Purchase of facilities from related persons were not ordinarily certified. Applications were denied involving purchase of land from the president of the applicant corporation or from his father, or from companies having substantial interlocking stock interests. However, the cost of transporting facilities from the plant of one related person to another was certified.

Second-hand Facilities. Care was also taken in screening applications for purchases of second-hand facilities. Used freight cars sold by one railroad to another were on occasion denied as were purchases of used locomotives, ships and barges. Such transfers did nothing to increase over-all transportation facilities. On the other hand, where barges were bought second-hand for $59,000, the cost of reconditioning was $400,000 and the barges had been idle for a year due to the completion of a bridge which rendered unnecessary their former use as ferries, the purchase price and

reconditioning cost were certified. A similar rule was applied to already existing plants or buildings, although in such cases it was ordinarily easier to prove the transfer was necessary. Thus, while acquisition of an existing grain storage elevator was denied certification, the acquisition of a textile factory which was going to be junked, was certified. Purchase of a brewery to be used for dried egg production (urgently required by Lend-Lease) was certified; such conversions from normal use to war use were, indeed, common—from production of permanent waving machines to aircraft instruments, from soda fountain equipment to machine guns, from pants pressing to 20 mm. shot, from coffins to shells. With second-hand equipment such as tools, or materials, it was not ordinarily feasible to inquire as to previous use, and certification was made where the acquisition was necessary. Inquiry, in fact, had revealed on occasion a decided increase in usefulness; an example was use by an ordnance manufacturer of steel acquired from a World's Fair Building.

Defense Plant Corporation Facilities. The Defense Plant Corporation had been organized by the Reconstruction Finance Corporation to finance war facilities which were to be privately operated but government-owned (owned by the Defense Plant Corporation) and leased to the operator. In certain cases the operator desired to purchase the facility from the Defense Plant Corporation. Such acquisition would not have increased over-all productive capacity but it would have encouraged use of private capital in war industry. The conclusion was reached that, in general, acquisitions from the Defense Plant Corporation were not within the scope of the Amortization Law and applications for their certification were denied.

Motive. The applicant's motive in making the expansion was not inquired into. A tramway installed in a coal mine was certified on evidence that it increased production despite an indication that the applicant's motive was to save money in disposing of waste material. Similarly, an addition to power plant facilities apparently made to save costs was certified on evidence that the addition saved fuel. The original use of the facility, however, was considered important. In an early case, a building had been erected to produce 70% peacetime products and 30% war products. A 30% certificate was granted. Later, the owner (without additional expense) converted the remaining 70% of its plant to war work and requested 100% certification. The request was denied. In a somewhat similar case, a plant was erected to produce an unnecessary product (91 Octane gasoline) in 1940. Two years later, the applicant erected additional facilities which, when combined with the 1940 facilities would produce a necessary product (100 octane gasoline). Certification was limited to the 1942 facilities. In yet another case, the applicant started to build a factory for production of electric sirens. Before construction was completed, the applicant was advised that electric sirens were not necessary. It accordingly completed its building to produce certain Ordnance supplies (which were necessary). The entire construction was certified.

### Efforts to Limit Amortization

By the spring of 1943 it was becoming apparent that the chief limiting factor in the production of war supplies no longer was facility capacity but materials and manpower. The use of steel and manpower to create factories, which could not then be fully used

because of a lack of materials and workers, would do injury to the war effort. The search for maximum war production now required, not an encouragement of facility expansion, but a curbing of it. On May 12, 1943 the War Production Board publicly announced:

With the exception of certain special programs, some special machinery, and further expansion of raw materials production, the United States at last has the machine tools and the capital equipment it needs to build production to defeat the Axis. For the first time in its history, the nation now has a physical plant adequate to make the maximum use of its resources in men, skill and materials.

An examination of our production effort up to that point revealed that the nation had devoted almost as much effort to the construction of necessary facilities as it had to the actual production of arms and munitions. Thereafter, it was believed, the greater part of the plants and materials which had been used so far in making machinery and equipment ought to be devoted directly to manufacturing planes, guns, tanks, and other munitions. It was suggested, therefore, that steps be taken either to restrict certification very rigidly, or to terminate it entirely.

Another factor also suggested the need for a reconsideration of the amortization problem. The broad language of the act did not limit amortization to facilities for producing supplies for direct military or naval use. An increasing number of applications came in for certification of facilities in fields not under the control of the War and Navy Departments. Facilities needed in connection with transportation, the processing of food, and the production of raw materials were all deemed necessary by the agencies charged with coordinating these activities. During the period when facilities for direct military and naval

supplies constituted the bulk of the expansion program, and other facilities were of minor significance, certification of cases of the latter type had been made by the War and Navy Departments upon the recommendation of the other agencies. However, in view of the fact that the War and Navy Departments were usually not directly conversant with the needs of the particular cases, it was thought that, if these cases were going to increase, certification ought to be by some other agency better able to judge their merits.

On June 25, 1943 the matter was submitted to the Office of War Mobilization, with a suggestion of possible alternatives. The Director of War Mobilization, after considering the matter, directed the War and Navy Departments to amend the regulations governing the issuance of Necessity Certificates so as to provide that certification should be discontinued. He did suggest, however, that the issuance of certificates for facilities for a military or naval supply might still be authorized in exceptional and limited cases where the need had been determined before expansion. A survey among the supply services of the War Department had revealed that in some programs further expansion was required.

Therefore, an amendment to the existing regulations was submitted to the President for approval. This provided that with the exception of facilities contracted for before the date of the amendment, no facility could be considered for certification unless the certificate was issued before the expansion started. It also provided that further certification under this restriction should be made only in cases of facilities for a supply for miltiary or naval uses, and then only after consideration of the relative advantage of governmental financing as against private financing with amortization. Simultaneously, the technical services

of the War Department were advised that, where additional facilities were required and were not available from Government-owned facilities, and the private companies which could provide them were unwilling to finance them without amortization, arrangements should be made for Government financing. A few cases, it was recognized, might still arise which ought to be handled by amortization, but they would be limited to exceptional situations.

The amendment was approved by the President on October 5, 1943. Subsequently, notwithstanding the amendment, the War Department was strongly urged to issue certificates for facilities for purposes not directly military but nevertheless claimed to be essential to national defense. The Office of Defense Transportation, in particular, had urged that transportation facilities be expanded to relieve the tight situation created by increasingly heavy shipments to the West Coast. On November 1, 1943, the War Department called this situation to the attention of the Office of War Mobilization with the suggestion that if certification was to be made in such cases, it should be done by the War Production Board. Thus, the question of amortization could be settled by the same agency which authorized the use of materials for the contemplated expansion. On December 17, 1943, the President, by Executive Order, transferred the function of issuing Necessity Certificates in all future cases from the Secretary of War and the Secretary of the Navy to the Chairman of the War Production Board. The War and Navy Departments, however, were to decide the applications then on file.

Non-Necessity and Payment Certificates. By Executive Order No. 9486 of September 30, 1944, the power and the responsibility of the War Department in the issuance of Non-Necessity Certificates

was transferred to the Chairman of the War Production Board, to be exercised by him in connection with his responsibility for guiding reconversion from war to peace-time production. By Executive Order No. 9490 of October 20, 1944, all the remaining functions of the War Department in connection with certification under Section 124 were likewise transferred to the Chairman of the War Production Board. This latter order covered amendments of Necessity Certificates already issued and Payment Certificates under subsection (h). Since the War Department had never issued a Non-Necessity Certificate under subsection (d), and had issued only three Payment Certificates under subsection (h), Executive Order No. 9490 in effect transferred a function which had never been exercised.

### Statistical Summary

In the period between the passage of the Tax Amortization Act and the transfer of the certification authority to the War Production Board, 31,047 applications for Necessity Certificates were filed for consideration by the War Department. From among that number the War Department issued 26,775 certificates covering the whole or part of the application. The remaining 4,272 cases were denied, withdrawn, or otherwise disposed of. The total dollar value of the facilities certified, on the basis of their estimated worth on the date of application, was $4,955,813,760.16.

A break-down of the figures is provided in the table which follows. It should be noted that the total in this table is three hundred million less than that cited above. The difference arises from the fact that the table is taken from the statistics compiled, first by the Advisory Commission, and later by the statistical sections of the War Production Board after the Advisory

Commission ceased to be a joint certifying authority in October 1941. In this compilation, after April 1943, all facilities of less than $25,000 in value in any one plant were excluded. The War Department figures includes them.

| *Type of Product* | *Estimated Cost* | *Percentage* |
|---|---|---|
| Manufacturing | | |
| Aircraft, Engines, Parts & Access. | $365, 731, 000 | 7. 93 |
| Ship Construction & Repair | 12, 234, 000 | 0. 27 |
| Combat & Other Motorized Vehicles | 100, 547, 000 | 2. 18 |
| Guns | 95, 846, 000 | 2. 08 |
| Ammunition, Shells & Bombs | 135, 372, 000 | 2. 93 |
| Explosives & Ammunition Loading | 13, 025, 000 | 0. 28 |
| Iron & Steel | | |
| Basic | 270, 062, 000 | 5. 85 |
| Fabricated | 82, 009, 000 | 1. 78 |
| Nonferrous Metals & Their Products | | |
| Aluminum & Magnesium | 306, 462, 000 | 6. 64 |
| Other | 56, 265, 000 | 1. 22 |
| Mach. Tools & Other Metal Work. Equip. | 158, 603, 000 | 3. 44 |
| Machinery and Elec. Equip. & Appl. | 213, 273, 000 | 4. 62 |
| Chemicals | | |
| Synthetic Rubber | 40, 440, 000 | 0. 88 |
| Other | 288, 405, 000 | 6. 25 |
| Coal and Petroleum Products | | |
| Aviation Gasoline | 437, 727, 000 | 9. 49 |
| Other | 100, 863, 000 | 2. 19 |
| Food Processing | 35, 373, 000 | 0. 77 |
| Miscellaneous | 319, 777, 000 | 6. 93 |
| TOTAL MANUFACTURING | $3, 032, 014, 000 | |
| Mining and Industrial Service | | |
| Mining | 82, 318, 000 | 1. 78 |
| Gas, Light, Heat and Power | | |
| Electric Power Generation | 123, 837, 000 | 2. 68 |
| Electric Power Transmission | 109, 032, 000 | 2. 36 |
| Gas Manufacture and Transmission | 48, 499, 000 | 1. 05 |
| Steam, Heat and Power | 6, 404, 000 | 0. 14 |
| TOTAL MINING | $370, 090, 000 | |
| Transportation and Related Service | | |
| Rail | 1, 066, 868, 000 | 23. 13 |
| Pipe-line | 17, 654, 000 | 0. 38 |
| Motor, Air and Water | 84, 489, 000 | 1. 83 |
| Terminal Facilities | 2, 371, 000 | 0. 05 |
| TOTAL TRANSPORTATION | $1, 171, 382, 000 | |
| Communication | 6, 419, 000 | 0. 14 |
| Non-Industrial Service | 32, 931, 000 | 0. 71 |
| GRAND TOTAL | $4, 612, 836, 000 | |

After the transfer of the certification authority to the War Production Board, the War Department's

action upon new applications was limited to making recommendations at the request of the War Production Board when it was claimed that the facilities were necessary for military supply. The fact that relatively few cases came up in which the need for additional privately financed facilities for military supply was established confirmed the War Department in its belief that the need for amortization as an inducement to the private financing of such facilities had come practically to an end. The War Department disposed of its backlog of about five thousand applications filed prior to the transfer of the certification authority by July 19, 1944.

## Conclusion

The history of the Tax Amortization Law, and of its administration by the War Department, are topics full of technical and difficult detail. Yet, behind these complexities, lay the stark necessities of national defense in one of the greatest emergencies of our history. We either had to build an unparalleled munitions industry within the space of a few months or face disaster. We had to do so within the framework of the system of private enterprise, not only because that was the system in which we believed, but also because it was the system we had, and any attempt to change it suddenly would have brought dangerous confusion and delay.

This could not be achieved, however, merely by broad declarations of principle. Appeals to patriotism alone could not relieve the individual manufacturer of the necessity for remaining solvent. He could be asked to undertake the rapid expansion which national defense required for an activity of uncertain duration, only if he were given reasonable protection

against bankruptcy at the end of the effort. The Tax Amortization Law was designed to provide that protection.

But the mere passage of the law did not remove the difficulty. Under any circumstances difficult problems of administering it would have arisen, problems which, unless solved, could largely destroy its intended effect. Danger came from two directions. On one side, the law had to be administered so as to make it possible for the manufacturer actually to secure the protection it was designed to provide and to secure it so promptly that he would begin work at once. On the other hand, the Government had to be protected against any action under the law which might confer upon firms using it advantages beyond those legitimate and necessary to the enlisting of the cooperation in building defense facilities. Under the special circumstances which existed between the fall of France and Pearl Harbor, a belief that the Tax Amortization Law was being used as a means to gain undeserved profits might have reacted disastrously upon the whole defense program.

The problem of the administration of the law was, therefore, an unusually thorny one. It was necessary to map a careful course which would secure haste without waste. Little help could be gained from precedent of past experience. Many difficulties were encountered. Not all of them were solved satisfactorily; perhaps some of them never could have been. Nevertheless, we got the plants, which in turn produced the guns, tanks, and planes. It is a reasonable conclusion that, without the Tax Amortization Law the construction of our munitions industry would have been seriously retarded. Had that occurred, our

position today might have been very different from what it is.

ROBERT P. PATTERSON
*Under Secretary of War*

Filed Dec 30 1946

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EXHIBIT F

Filed Dec 30 1946

WAR PRODUCTION BOARD

WASHINGTON, D. C.

February 9, 1944

## MEMORANDUM

To: The Industry Divisions, War Production Board
Facilities and Inspection Branch, Production Division, War Department
The Bureaus of the Navy Department
U. S. Maritime Commission
The Office of War Utilities
The Office of Defense Transportation
The Petroleum Administrator for War
War Foods Administration
Office of the Rubber Director

From: The Facilities Bureau
Deputy Director for Tax Amortization

Attached is a statement designed to be of aid in the preparation of recommendations. It is not intended to be all inclusive. Additional information may, from

time to time, be requested by members of the staff of the Tax Amortization Branch.

CARMAN G. BLOUGH
Carman G. Blough
*Deputy Director for Tax Amortization Facilities Bureau*

## PREPARATION OF RECOMMENDATIONS FOR TAX AMORTIZATION

The Government's substantial monetary interest in facilities covered by a Necessity Certificate must be recognized. Amortization represents an abnormal tax deduction and hence a loss of revenue to the Government. In the case of companies in the higher tax brackets, this may amount to 81 percent of the cost of the facilities.

No facility will be certified unless the war effort would actually be weakened by the lack thereof. This bears upon the degree of essentiality. The facility cannot be merely desirable, helpful or appropriate. It must be essential and must be required exclusively for production of one or more of the supplies enumerated in Section (3) (a) of the WPB Regulations governing the issuance of Necessity Certificates. An overall shortage of facilities in the industry or a situation covered by Section (3) (b) (ii) of the Regulations must be found to exist.

In determining whether it is to the advantage of the Government that the facilities be privately financed, consideration must be given to the probable marketability or useful value of the facility after the war. It is recognized that there is no way by which post-war value can be definitely determined at this time. Any facility which will not have a reasonably wide market

may be assumed to have relatively little post-war sales value, and therefore, it would be to the best interest of the Government that it be privately financed. On the other hand, if a facility appears to be of such a type that it would have a reasonably wide market after the war, it may generally be assumed that, provided the DPC or other government agency is willing to purchase it, it would be to the advantage of the Government that it be publicly rather than privately financed with a 100 percent certificate. It may still be advantageous to the Government to have private financing under a certificate if a percentage certificate were issued, such percentage being based, for example, on excess cost attributable to the war.

Reports must contain the findings required by Section (3) (b) of the Regulations, the most fundamental of which is the finding of an overall shortage of facilities required for the production of supplies necessary in the interest of national defense. Replacements, acquisitions from an affiliate, etc., must be commented on.

Reports must contain an expression of opinion whether it is to the advantage of the Government that the facilities be privately financed and must state the reasons. A favorable recommendation must contain a statement that, recognizing the Government's financial interest in a certified facility, the facilities listed in Appendix A are so essential to the progress of the war that the reporting agency recommends issuance of a certificate.

Reports must contain a statement of the percentage of cost recommended for certification.

EXHIBIT G

Form GA–141
(7–20–43)

CIRCULAR SERIES SUPPLEMENT NO. 1 TO GENERAL PROGRAM CIRCULAR

No. 33
Date: March 8, 1944

United States of America War Production Board
Page 1 of 3

To: All Bureau and Division Directors
Approved: J. A. Krug Program Vice Chairman
Issued through: L. M. Shea Esq. Office of Procedures

SUBJECT: CRITERIA FOR PREPARATION OF RECOMMENDATIONS FOR NECESSITY CERTIFICATES ON FORM GA–1231

*Section 1 Purpose:*

.01 The purpose of this supplement is to prescribe revised requirements for reports on applications for Necessity Certificates which are hereafter to be incorporated as part of Form GA–1231. These requirements are supplementary to the statement that was attached to memorandum to the Industry Divisions, War Production Board, and other interested Agencies from the Facilities Bureau Deputy Director for Tax Amortization, dated February 9, 1944, and are intended to clarify and expand it, but not to change it in any way. (See Page 3.)

.02 The new data is designed to furnish the information needed to make a decision on an application for a Necessity Certificate in most cases, but additional information may, from time to time, appear to the sponsor to be pertinent or be requested by members of the staff of the Tax Amortization Branch.

*Section 2 Information to be furnished by Sponsoring Agency or Division on Form GA–1231:*

.01 The following information must be supplied before applications for Necessity Certificates will be approved. Sponsoring agencies or industry divisions will be held responsible for the presentation of such data.

1. Is the end product of vital importance to the war effort? _____ If the answer is "Yes", state the basis for such a conclusion.
2. Is there an overall shortage of facilities to produce as against requirements for this product? _____ If so, explain.
3. If there is no overall shortage of facilities, is there an area shortage? _____ If so, state why it is imperative that the applicant increase production facilities rather than have the deficiency made up by another source.
4. Is acquisition or construction by the applicant of each facility listed clearly necessary for production of the end product? _____ Specify all facilities not clearly necessary.
5. Are these facilities wholly or partly a replacement? _____ If so, explain and state what part.
6. Are these facilities to be acquired from an affiliate? _____
7. Would the Government be in a good bargaining position after the War if these facilities should be publicly financed? _____ If not, state why.
8. Are they of a type that are likely to have a reasonable postwar value? _____ If not, state why.

9. Is it reasonable to assume that the facilities are of such a type that they may be useful to the applicant after the War? _____ If not, state why.

10. Comments:

11. Recommendations:

A. Based upon the foregoing it is recommended that the application be denied.

Signed _____

(over)

General Program Circular No. 33, Supp. No. 1



B. Based on the foregoing it is our opinion that it is to the advantage of the Government that the facilities be privately financed. In addition, recognizing the Government's financial interest in a certified facility, we are of the opinion that the facilities listed in Appendix A are so essential to the progress of the War that the issuance of a certificate up to _____% of cost is recommended.

Signed _____

*Section 3 Effective Date for Required Information:*

.01 The revised requirements for reports on applications for Necessity Certificates given in Section 2 are to be incorporated as a part of Form GA–1231. Whether the new forms are available or not, all reports from Sponsoring Agencies or Divisions, dated after March 10, 1944, must contain this information or they will be returned without action.

399371—56——5A

*Section 4 Instruction for determining Recommendation on Form GA–1231:*

.01 By applying the answers to the questions given in Section 2 and eventually to be included on Form GA–1231, one of the following recommendations should be made:

1. That no certificate should be issued.
2. That the facilities should be partially certified (state specific percentage recommended).
3. That facilities should be certified 100%.

.02 In the event that amortization should be allowed, determination as to whether it should be 100% or partial should be made as follows:

1. One hundred percent certificate will be given only when facilities to be amortized are wholly designed to manufacture end product exclusively for war purposes or for essential civilian use, and it is not reasonable to assume that they may be useful after the war.
2. Partial certificate representing excess construction or acquisition costs over pre-war costs[1] will be given when facilities to be amortized are wholly designed to manufacture end product exclusively for war purposes or for essential civilian use and it is reasonable to assume that they may be useful after the war.
3. Partial certificate will be given in appropriate percentages under certain other circumstances

[1] It is impossible to predict whether post-war costs will be above or below present costs, yet it appears equitable to relate them to pre-war costs. Accordingly, pre-war costs are to be used in determining this partial certificate, and as a general rule pre-war costs are to be considered as being those in effect during the years 1937–1939 inclusive.

of an extraordinary nature. The following are examples:

a. When part of the facilities are appropriate for government financing and part for a 100% certificate, a percentage certificate may be issued for the entire project at a percentage which will result in same amount of tax amortization that would have been allowed had the individual items been considered separately.

b. When a facility is a replacement, but a more expensive facility is required because of special war needs than would be required for normal operations of the Company, a percentage certificate may be issued covering the excess of the cost of the facility over the cost of the type of facility that would have been otherwise required.

c. When the facility is clearly necessary to the war effort, but its capacity or cost is in excess of that which is necessary for the war effort, the percentage should be determined in such a way as to make no amortization allowance applicable to the excess capacity or cost.

General Program Circular No. 33, Supp. No. 1

Page 3 of 3

Attachment to Memorandum, February 9, 1944

## Preparation of Recommendations for Tax Amortization

The Government's substantial monetary interest in facilities covered by a Necessity Certificate must be recognized. Amortization represents an abnormal tax deduction and hence a loss of revenue to the Government. In the case of companies in the higher tax

brackets, this may amount to 81 percent of the cost of the facilities.

No facility will be certified unless the war effort would actually be weakened by the lack thereof. This bears upon the degree of essentiality. The facility cannot be merely desirable, helpful or appropriate. It must be essential and must be required exclusively for production of one or more of the supplies enumerated in Section (3) (a) of the WPB Regulations governing the issuance of Necessity Certificates. An overall shortage of facilities in the industry or a situation covered by Section (3) (b) (ii) of the Regulations must be found to exist.

In determining whether it is to the advantage of the Government that the facilities be privately financed, consideration must be given to the probable marketability or useful value of the facility after the war. It is recognized that there is no way by which post-war value can be definitely determined at this time. Any facility which will not have a reasonably wide market value may be assumed to have relatively little post-war sales value, and therefore, it would be to the best interest of the Government that it be privately financed. On the other hand, if a facility appears to be of such a type that it would have a reasonably wide market after the war, it may generally be assumed that, provided the DPC or other government agency is willing to purchase it, it would be to the advantage of the Government that it be publicly rather than privately financed with a 100 percent certificate. It may still be advantageous to the Government to have private financing under a certificate if a certificate were issued, such percentage being based, for example, on excess cost attributable to the war.

Reports must contain the findings required by Section (3) (b) of the Regulations, the most funda-

mental of which is the finding of an overall shortage of facilities required for the production of supplies necessary in the interest of national defense. Replacements, acquisitions from an affiliate, etc., must be commented on.

Reports must contain an expression of opinion whether it is to the advantage of the Government that the facilities be privately financed and must state the reasons. A favorable recommendation must contain a statement that, recognizing the Government's financial interest in a certified facility, the facilities listed in Appendix A are so essential to the progress of the war that the reporting agency recommends issuance of a certificate.

Reports must contain a statement of the percentage of cost recommended for certification.

Inquires should be directed to the Tax Amortization Branch, Facilities Bureau.

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UNITED STATES GRAPHITE CO. *v.* HARRIMAN, SECRETARY OF COMMERCE

Civ. A. No. 36695

District Court of the United States for the District of Columbia

June 17, 1947

[71 F. Supp. 944]

[Headnotes omitted]

PINE, *Justice.*

Plaintiff is a manufacturer of a graphite product known as "graphitar." It is used particularly in the

manufacture of marine and aircraft engines. In 1943 the demand for graphitar began to exceed the capacity of plaintiff's plant. Accordingly, plans were made for a factory addition and for the necessary machinery and equipment therein required. On June 27, 1943, plaintiff filed an application for a certificate of necessity under Section 124 of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, § 124, in order that it might secure a deduction for amortization of the entire cost of the factory addition upon its Federal income and excess profit tax returns, and on October 28, 1943, a necessity certificate was issued therefor.

On May 29, 1944, plaintiff filed an application for a necessity certificate covering facilities (machinery, etc.) for use in the factory, which had then been constructed. Thereafter plaintiff received a communication dated July 17, 1944, and entitled "letter of predetermination," stating that these facilities were eligible for tax amortization on a 35% basis, provided the date of acquisition was subsequent to the date of such letter. On July 27, 1944, plaintiff filed an affidavit showing that a portion of such facilities had been acquired prior to the date of the letter of predetermination and that the balance had been acquired thereafter; whereupon there was issued to the plaintiff a necessity certificate for that part of the facilities listed as being received after the date of the letter of predetermination, up to 35% of their cost. Thereafter plaintiff demanded the issuance of a certificate which would include the entire cost of all the facilities, irrespective of the date of acquisition. This being refused, plaintiff brought this action to compel its issuance.

Defendant first moved to dismiss the complaint, and subsequently moved for a summary judgment. The action is before me for decision on these motions.

The issuance of this certificate of necessity is authorized by Section 124 of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, § 124. Designed to stimulate the investment of private capital in defense facilities, this statute authorized the amortization of their cost as a tax deduction over a period of five years or less.

Plaintiff contends that defendant's predecessor, the War Production Board,[1] had no legal right to issue a necessity certificate for only 35% of the cost of the facilities acquired after the date of the letter of predetermination, but, once having determined to issue a necessity certificate, was required to issue one for the entire cost of the facilities acquired, both before and after such date.

The applicable provisions of this statute are contained in Section 124 (f) of the Internal Revenue Code, reading, so far as material, as follows: "(f) * * * In determining * * * the adjusted basis of an emergency facility—

"(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such * * * acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as

[1] Defendant's immediate predecessor was the Temporary Controls Administrator, whose predecessors were, in the order named, Civilian Production Administrator and the War Production Board, the Chairman of which was vested with the functions of the Secretary of War and the Secretary of the Navy under Section 124 of the Internal Revenue Code. Executive Order No. 9841, 50 U. S. C. A. Appendix, § 601 note, April 23, 1947; Executive Order No. 9809, 50 U. S. C. A. Appendix, § 601 note, December 12, 1946; Executive Order No. 9638, 50 U. S. C. A. Appendix, § 601 note, October 4, 1945; Executive Order No. 9406, 50 U. S. C. A. Appendix, § 601 note, December 17, 1943.

necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President. * * *

"(3) The certificate provided for in paragraph (1) shall have no effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition * * *."

The applicable provisions of the Regulations[2] prescribed under the above-quoted statute are as follows:

"(3) (c) (vi) Government and privately financed facilities. Necessity Certificates will be issued only where it is to the advantage of the government that the facilities in question be privately financed.

"(4) Application must be filed before construction is begun or date of acquisition. The construction, reconstruction, erection, installation or acquisition of a facility will not be deemed necessary within the terms of these regulations unless a determination of necessity is made by the certifying authority prior to the beginning of the construction, reconstruction, erection, installation or date of acquisition."

[1] It will be noted that Section 4 of the Regulations, above quoted, provides that the acquisition of a facility will not be deemed necessary unless a determination of necessity is made prior to the date of acquisition. Defendant's action in limiting the certif-

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[2] Regulations governing the issuance of necessity certificates under Section 124 (f) of the Internal Revenue Code prescribed by the Chairman of the War Production Board with the approval of the President, dated December 17, 1943. 8 F. R. 16964.

icate of necessity to the facilities acquired after the letter of predetermination appears to be authorized by this regulation, and plaintiff does not contend to the contrary. Instead, it places its reliance upon the claim that the regulation contravenes the statute. The question, therefore, is whether the six-month period may be shortened by regulation, the effect of which was to apply a brake on overexpansion of plant facilities, by requiring their necessity to be determined prior to acquisition in order to be eligible for tax amortization. As above set forth, the statute provides that the necessity certificate shall have no effect unless application therefor is filed before the expiration of six months after date of acquisition. But the statute also contemplates its implementation by regulation, and expressly provides that certification of necessity shall be under regulations prescribed from time to time by the executive officials. Under defendant's interpretation, the statute permits these officials, in the exercise of discretion, to shorten, by regulation, the time for filing applications for necessary certificates, but places an outside limit of six months on their effectiveness, beyond which executive discretion ceases. This construction would seem to be warranted, in view of the clear purpose of Congress to provide flexibility in administration to meet changing conditions and circumstances in the prosecution of the defense program; but in any event, defendant's construction being reasonable, it cannot be set aside by the courts in this proceeding.[3]

[3] *Adams* v. *Nagle*, 303 U. S. 532, 542, 58 S. Ct. 687, 82 L. Ed. 999; *Wilbur* v. *United States ex rel Kadrie*, 281 U. S. 206, 219, 50 S. Ct. 320, 74 L. Ed. 809; *Work* v. *United States ex rel Rives*, 267 U. S. 175, 182, 183, 45 S. Ct. 252, 69 L. Ed. 561; *United States ex rel Riverside Oil Co.* v. *Hitchcock*, 190 U. S. 316, 323, 23 S. Ct. 698, 47 L. Ed. 1074; *Thomas* v. *Vinson*, 80 U. S. App. D. C. 346, 349, 153 F. 2d 636; *Red Canyon Sheep Co.* v. *Ickes*, 69 App. D. C. 27, 41, 98 F. 2d 308; *United States ex rel Corbin* v. *Doyle*, 68 App.

[2, 3] In respect of the second contention of plaintiff, that the statute does not authorize defendant to limit the amortization deduction to 35% of the cost, it should be pointed out that the statute requires that there shall be included *only so much* of the amount as is properly attributable to acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy [later Chairman, War Production Board] has certified as necessary in the interest of national defense, which certification shall be under such regulations as may be prescribed from time to time by the executive officials with the approval of the President. Among the regulations prescribed is Section (3) (c) (vi), supra, which provides that necessity certificates will be issued only where it is to the advantage of the government that the facilities be privately financed. Certification under this statute, as implemented by this regulation, clearly involved an exercise of discretion, which will not be set aside unless unreasonable, arbitrary or capricious.[4] Here the certification was made pursuant to an established policy of the War Production Board which, after December 17, 1943, was vested with the functions of the Secretary of War and the Secretary of the Navy, Executive Order No. 9406. This policy limited amortization to excess war cost (estimated at 35%) in the

D. C. 100, 104, 93 F. 2d 646; *United States ex rel White* v. *Coe*, 68 App. D. C. 218, 220, 95 F. 2d 347; *Ickes* v. *Pattison*, 65 App. D. C. 116, 119, 80 F. 2d 708, *Reichelderfer* v. *Johnson*, 63 App. D. C. 334, 72 F. 2d 552; *Stockey* v. *Wilbur*, 61 App. D. C. 117, 118, 58 F. 2d 522.

[4] *Wilbur* v. *United States ex rel. Kadrie, supra; Work* v. *United States ex rel. Rives, supra; United States ex rel. Riverside Oil Co.* v. *Hitchcock, supra; Calf Leather Tanners Ass'n* v. *Morgenthau*, 65 App. D. C. 93, 98, 99, 80 F. 2d 536; *United States ex rel. Bowling* v. *Hines*, 60 App. D. C. 180, 181, 50 F. 2d 330; *McCarl* v. *Rupp*, 60 App. D. C. 111, 48 F. 2d 1023; *McCarl* v. *Walters*, 60 App. D. C. 237, 238, 38 F. 2d 942.

case of facilities having presumptive postwar utility, which was found by the Board to be true of the facilities here involved. This would appear to be in furtherance of the legislative purpose to encourage capital investment in the defense effort which would not be available because of fear that such investment would have no postwar value, and at the same time maintain the amortization benefits under such control that they would not unduly injure the revenue. Thus there is no showing that the exercise of this discretion comes within the exception permitting courts to intervene. So far as its exercise involves interpretation of the statute in question, the statement made in the preceding paragraph is equally applicable to the point here under discussion.

Accordingly the motion for summary judgment will be granted. Counsel will present, on notice, judgment carrying this opinion into effect.

United States Court of Appeals for the District of Columbia Circuit

No. 9680

THE UNITED STATES GRAPHITE COMPANY, APPELLANT

*v.*

CHARLES SAWYER, SECRETARY OF COMMERCE, APPELLEE

Appeal from the District Court of the United States for the District of Columbia (now United States District Court for the District of Columbia)

Argued October 7, 1948. Decided February 28, 1949

Before EDGERTON, CLARK, and WILBUR K. MILLER, *JJ.*

*Per curiam:* The judgment is affirmed on the opinion of Judge Pine in the District Court. *United States Graphite Co.* v. *Harriman,* 71 Fed. Supp. 944.

WILBUR K. MILLER, J., dissenting: As my brethren have approved and adopted the District Court's opinion without reproducing it, I shall restate the case before giving the reasons for my dissent.

In an effort to induce private enterprise to use its own funds in expanding manufacturing facilities to meet the requirements of national defense, the Congress enacted in 1940 § 124 of the Internal Revenue Code. Subsection (a) thereof is in part as follows:

> Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (e)), based on a period of sixty months. * * *

This is unequivocal and imperative language and is a grant of a right to the deduction described. If a later provision of § 124 is to be held to have modified a taxpayer's absolute right to the five-year amortization described in subsection (a) by giving to an administrative agency authority to restrict the amortization to something less than the entire cost, I take it that the intention of Congress to do so should be expressed in clear and unmistakable terms.

An emergency facility was defined by subsection (e) as one (a) which had been constructed or acquired after December 31, 1939, and (b) which had been certified by the proper authority as necessary in the interest of national defense.[5]

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[5] The pertinent portion of subsection (e) is as follows:

(1) *Emergency facility.* As used in this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made. For

The appellant is a manufacturer of a graphite product known as "graphitar." In 1943 when the government required for war purposes greater quantities of graphitar than appellant could produce, the War Department insisted that it double its capacity by erecting a new building and installing therein the necessary machinery and equipment.

Relying—naively, as it turned out—on the provisions of § 124 of the Internal Revenue Code, the appellant erected the building and began the acquisition of machinery and equipment. With respect to the building, the appellant applied on June 27, 1943, for a necessity certificate under subsection (f) (1) of § 124, and received it from the Secretary of War on October 28, 1943. The entire cost of the building could therefore be amortized for tax purposes in the statutory five-year period. But with the acquisition of machinery, the appellant's troubles began. On May 29, 1944, and within six months after the installation of certain machinery and equipment, appellant ap-

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the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by any person after December 31, 1939, and not earlier than six months prior to the filing of an application for a certificate under subsection (f), and with respect to which part a certificate under subsection (f) has been made, shall be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than six months prior to the filing of such application. For the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by a corporation after December 31, 1939, and before June 11, 1940, and with respect to which part a certificate under subsection (f) has been made, shall be deemed to be an emergency facility and to have been completed on June 10, 1940, notwithstanding that the entire facility was not completed until after June 10, 1940.

plied for a covering necessity certificate to the War Production Board, which by Executive Order had succeeded the Secretaries of War and the Navy as the certifying agency. Although both building and machinery were essential to the increased production which the War Department wanted, the War Production Board refused to certify the full cost of the machinery. The Board issued to appellant on July 17, 1944, what is called a "letter of predetermination," stating the machinery and equipment would be eligible for amortization, but attaching two conditions which the appellant asserts were unauthorized.

Those conditions were: (1) that the machinery and equipment acquired by the appellant prior to July 17, 1944, the date of "predetermination," could not be amortized, and (2) that only 35 per cent of the cost of machinery and equipment acquired after that date could be amortized.

The first condition was imposed by the Board pursuant to its own regulation that a necessity certificate would not be issued unless application therefor had been made before the construction or acquisition of the facility.

The second condition was imposed by the Board because it had concluded that only 35 percent of the cost of appellant's machinery installed after the date of "predetermination" could be certified as necessary to national defense, its idea being that "the facilities sought to be certified were of such a nature as to be presumably useful in post-war operations." Apparently the Board's theory was that 35 percent of the cost of the machinery represented war-caused excess over the pre-war cost.

With respect to the first condition imposed by the Board pursuant to its regulation that application for certification must be made before the facility had been

constructed or acquired,[6] the question is as to the validity of the regulation. To be sure, the Board had express authority under subsection (f) (1) to prescribe regulations governing certification. But a regulation may not conflict with the statute under which it is promulgated.

This regulation is in direct conflict with subsection (f) (3) of the statute, the pertinent portion of which follows:

> (3) The certificate provided for in paragraph (1) shall have no effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, or before December 1, 1941, whichever is later, * * *.

Because of the conflict with the statute, the regulation was invalid and did not confer upon the War Production Board power to exclude from the necessity certificate all the cost of the machinery and equipment which the appellant acquired prior to July 17, 1944. Application for certification of that cost was seasonably made under the terms of the statute and could not be refused on the ground that the application had not been made before acquisition as required by the invalid regulation.

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[6] The regulation, dated December 17, 1943, 8 Fed. Reg. 16964, was approved by the President and the pertinent portion is as follows:

> (4) *Application must be filed before construction is begun or date of acquisition.* The construction, reconstruction, erection, installation or acquisition of a facility will not be deemed necessary within the terms of these regulations unless a determination of necessity is made by the certifying authority prior to the beginning of the construction, reconstruction, erection, installation or date of acquisition.

The second condition imposed by the Board in its "letter of predetermination" which restricted the taxpayer to a deduction with respect to the amortization of only 35 percent of the cost of its machinery and equipment acquired after July 17, 1944, was authorized, the appellee contends, by § 124 (f) (1), which is as follows:

> * * * In determining, for the purposes of subsection (a) or subsection (h), the adjusted basis of an emergency facility—
>
> (1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President.

In order to reach the extraordinary conclusion that subsection (f) (1) authorizes the certification as necessary to national defense of less than 100 percent of the cost of a facility otherwise "emergency" in character, the appellee is forced to read subsection (f) (1) as though it provided:

> There shall be included in amortizable cost only so much of the cost of the facility as * * * the Secretary * * * has certified as necessary in the interest of national defense. * * *

Such reading omits important words in the subsection. It overlooks completely the fact that its language includes the following:

> * * * as is properly attributable to such construction * * * after December 31, 1939, as

> * * * the Secretary * * * has certified as necessary in the interest of national defense. * * *

The appellee's construction of subsection (f) (1) as meaning only so much of the cost as has been certified as necessary in the interest of national defense" does plain violence to the grammatical structure of the statutory sentence, for, as has been said, it leaves out important words. Careful reading of the poorly worded subsection reveals its meaning as

> There shall be included as amortizable cost only so much of the cost of the facility as is properly attributable to the part of it which was constructed after December 31, 1939, and which has been certified as necessary in the interest of national defense.

We have seen that subsection (e), in defining the term "emergency facility," expressly excluded anything constructed or acquired before December 31, 1939. That critical date of subsection (e) was carried on into subsection (f) (1), which undertook to govern a situation involving a facility, a part of which was constructed before December 31, 1939, and so could not be amortized, and the other part of which was constructed after that date and so could be certified for amortization. I admit the Congress did a poor job of statute writing in framing subsection (f) (1); but when all the subsections are read together the meaning can be spelled out. The mere fact that subsection (f) (1) is so written does not justify a construction of it which eliminates important words and thereby distorts it. I think subsection (f) (1) clearly means there can be amortized only the "adjusted basis" (which in this case means cost) of that physical portion of a facility which is "emergency" in character in that (a) it had been constructed after Decem-

ber 31, 1939, and (b) it had been properly certified as necessary in the interest of national defense.

The District Court's opinion which has been adopted by my brethren as the opinion of this court, includes the following:

> In respect of the second contention of plaintiff, that the statute does not authorize defendant to limit the amortization deduction to 35% of the cost, it should be pointed out that the statute requires that there shall be included ONLY SO MUCH of the amount as is properly attributable to acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy [later Chairman, War Production Board] has certified as necessary in the interest of national defense, which certification shall be under such regulations as may be prescribed from time to time by the executive officials with the approval of the President.

I suggest with deference, that the foregoing is a distortion of the grammatical construction of the statutory sentence. It leaves out significant words in the statute, as I have pointed out heretofore. For the statute says "only so much of the amount * * * as is properly attributable to such construction * * * as * * * the Secretary * * * has certified as necessary in the interest of national defense." Obviously the meaning is "such construction as the Secretary has certified as necessary"; therefore, that there shall be included only so much of the cost as is properly attributable to such construction, after the critical date, as has been certified as necessary. If that were not true, the word "such" before the word "construction" would be without significance.

The opinion of the District Court continues thus:

> * * * Here the certification was made pursuant to an established policy of the War Pro-

> duction Board which, after December 17, 1943, was vested with the functions of the Secretary of War and the Secretary of the Navy (Executive Order 9406). This policy limited amortization to excess war cost [estimated at 35%] in the case of facilities having presumptive postwar utility, which was found by the Board to be true of the facilities here involved. This would appear to be in furtherance of the legislative purpose to encourage capital investment in the defense effort which would not be available because of fear that such investment would have no postwar value, and at the same time maintain the amortization benefits under such control that they would not unduly injure the revenue.

This amounts to saying that Congress intended to write into § 124 the idea of value for post-war use which was the basis of amortization under a somewhat similar statute enacted in 1918.

Under the 1918 act, if a facility had post-war useful value the difference between that estimated value and actual cost was allowed as a special amortization deduction. The legislative history of the act now under consideration convincingly demonstrates that Congress deliberately and purposefully departed from the principle of the 1918 act because experience had demonstrated it to be unsatisfactory and not productive of the desired result.

I shall not prolong this dissent by going fully into the legislative history of § 124. One brief quotation from the testimony of the Assistant Secretary of the Treasury before the Senate Finance Committee will suffice to indicate the understanding which Congress had of the section as shown by the entire voluminous legislative history.

> Senator GEORGE. Is the certificate that is issued on the recommendation of the National

> Council and the Secretary of War or Navy, as the case may be, limited to mere certification that the particular facility is necessary for defense, or do they go further and specify what the depreciation and obsolescence amount to?
>
> Mr. SULLIVAN. No, they do not.
>
> Senator GEORGE. They turn that back to the Treasury?
>
> Mr. SULLIVAN. No, sir; under the bill automatically the amortization to which they are entitled is 20 percent a year, for 5 years.

At the time this discussion took place, subsection (f) (1) had been passed by the House and after this testimony the only change was to eliminate any participation by the Council of National Defense, leaving the certifying power to the Secretaries of War and the Navy.

We should remember that the five-year amortization provision is in reality nothing more than an acceleration of the ordinary allowable depreciation which in the course of time would retire the property.

A proposal that the government shall own all property which has been fully depreciated at the ordinary allowable rate would be generally rejected as unsound. It is therefore illusory to suggest, as was done in argument, that the government should take over all facilities fully amortized in five years under § 124. A suggested inclusion in the act of a provision that the government might acquire the facility at the end of amortization for the nominal consideration of $1.00 was rejected during congressional consideration.

After exhaustive study, I have been able to discover nothing in the language of the act, or in its legislative history, to indicate the Congress intended to give the certifying agency the right to determine that only a portion of the cost of a necessary facility could be amortized. The result in this case is so incongruous

as to be almost grotesque. Here the War Department, badly in need of large quantities of graphitar, insisted that the appellant erect a new building and equip it with the necessary machinery, which the appellant proceeded to do. The Secretary of War certified the building to have been necessary in the interest of national defense. It does not comport with common sense for the War Production Board in 1944 to certify that only 35 percent of a fraction of the cost of the machinery was necessary in the interest of national defense. The building alone could not produce graphitar and yet the building was certified as necessary in its entirety. It is not suggested that the need for graphitar was any less pressing in 1944 than in 1943.

For the reasons given I think the decision of the court is wrong. The judgment of the District Court should be reversed.

In the United States Court of Claims

No. 50224

(Decided December 2, 1952)

THE WICKES CORPORATION *v.* THE UNITED STATES

OPINION

MADDEN, *Judge,* delivered the opinion of the court:

The plaintiff seeks to recover from the Government excess profits tax in the amount of $43,610.29 for the year 1944 and of $93,146.01 for the year 1945. The taxes were paid by The United States Graphite Company. That company was later merged into the plaintiff company, which succeeded to its rights to the claims herein asserted. The instant dispute depends upon the proper interpretation and application of the statutes permitting a corporation which built or ex-

panded its plant or equipment in order to increase wartime production to amortize the cost of such plant or equipment over a short period of years, by deductions from its income for tax purposes.

Section 23 (t) of the Internal Revenue Code provided, during the years here in question, for the deduction from gross income of "the deduction for amortization provided in Section 124." Section 124 is, therefore, the key section in this case. That section, in subsection (a), said that a taxpayer at his election was entitled to a deduction on the basis of the amortization of any emergency facility during a period of sixty months. It referred to paragraph (e) for the definition of an emergency facility. The first sentence of subsection (e) says:

> As used in this section, the term "Emergency facility" means any facility, land, building, machinery or equipment, or part thereof, the construction, reconstruction, erection, installation or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made.

Subsection (f) said:

> In determining, for the purposes of subsection (a) or subsection (h) the adjusted basis of an emergency facility (1) There shall be included only so much of the amount otherwise constituting such adjusted basis [7] as is properly attributable to such construction, reconstruction, erection, installation or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certifica-

[7] The parties are agreed that the "adjusted basis" of the property here in question was its cost.

tion shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President.

For brevity, we refer to the plaintiff's predecessor, The United States Graphite Company, to whose rights the plaintiff has succeeded, as the plaintiff. It was, during the Second World War, engaged in the manufacture of graphitar, which was used by the armed services and the Maritime Commission in the construction of aircraft, ships and other equipment used in the prosecution of the war. In 1943 the Government's demand for graphitar exceeded the capacity of the plaintiff's plant and facilities. Procurement officials encouraged the plaintiff to enlarge its facilities, and the plaintiff, prior to June 27, 1943, made plans to do so. It was granted high priorities for the obtaining of the materials, supplies and equipment needed for the enlargement.

On June 27, 1943, the plaintiff, in order to obtain the benefits of the rapid amortization provided for in Section 124 of the Internal Revenue Code, applied to the Secretary of War for a "necessity certificate" covering its proposed new factory building. That certificate was granted on October 28, 1943, and is not here in question. When the building was under way, the plaintiff applied to the War Production Board for preference ratings or priorities to assist it in obtaining the machinery and equipment for the new plant. These applications were made from October 7 to December 10, 1943, and were promptly granted. The machinery and equipment were obtained by the plaintiff and installed in the factory on various dates between December 28, 1943, and December 15, 1944.

By Executive Orders issued in December 1943, and March 1944, the President transferred to the Chairman of the War Production Board the functions which had formerly been exercised by the Secretary of War and the Secretary of the Navy, with regard to the issuance of necessity certificates. On May 29, 1944, the plaintiff duly filed an application for such a certificate covering machinery and equipment having a total estimated cost of $255,002.79. To the application was appended a list of the items included. On July 17, 1944, the War Production Board advised the plaintiff by letter that it had been determined that the machinery and equipment listed in the plaintiff's application were eligible for tax amortization on a 35% basis, provided that the items were to be acquired after the date of the letter. The Board's letter said that a Certificate of Necessity would be issued, as of July 17, 1944, after the Board had received a schedule in affidavit form stating, with respect to each item, that it had not been acquired before July 17, 1944.

The requested affidavit was filed by the plaintiff on July 27, 1944. It showed, of course, that some of the facilities had been acquired before July 17, 1944, and that the others had been or would be acquired after that date. On or about July 31, 1944, but as of July 17, 1944, the Board issued to the plaintiff a necessity certificate stating that the facilities described in the attached Appendix A were "necessary in the interest of national defense during the emergency period, up to 35% of the cost" thereof. The attached Appendix A was the list which the plaintiff had submitted with its affidavit. The items thereon shown to have been received before July 17, 1944, were, however, crossed over with Xs made by a red pencil. On April 2, 1946, the Civilian Production Administration, which had,

apparently, succeeded to the functions of the War Production Board issued an amendment to the Necessity Certificate, which amendment listed in detail the actual cost of the facilities received before and after July 17, 1944. It showed that the cost of those received before that date was $77,195.99, and of those received after that date was $140,031.44. Those figures were correct, and the present controversy concerns only the application of the amortization law to those amounts.

At the request of the plaintiff for a statement of the reasons for its action, the Civilian Production Administration on August 12, 1946, wrote the plaintiff that it was the Administration's policy, in cases where the facilities to be acquired would be useful in postwar operations, to limit necessity certificates to 35% of the cost of the facilities. The plaintiff had, earlier, been orally advised that the 35% figure had been selected because that was the estimated excess of the cost of the facilities in wartime over what would have been their peacetime cost.

The taxing authorities, in imposing excess profits taxes upon the plaintiff, allowed it to deduct accelerated amortization upon only 35% of the cost of the facilities acquired after July 17, 1944, and no such amortization at all upon those acquired before that date. The plaintiff contends that it should have been allowed to deduct accelerated amortization upon the full cost of both kinds of facilities.

We consider first the facilities acquired after July 17, 1944. As to those, [the] War Production Board certified that they were eligible for accelerated amortization for tax purposes under section 124. The plaintiff says that the Board had no power to put the 35% limit on the amount of the cost of the facilities on which amortization should be computed. We agree

with the plaintiff. When Congress took the drastic step of conferring the important tax advantage of rapid amortization upon those private enterprises which would invest their own money in expanding their facilities to increase wartime production, it knew that in some cases the enterprises would have, at the end of the war, facilities still useful but which had been paid for, to a considerable extent, by reductions in income and excess profits taxes. See Hearings before the Senate Committee on Finance on the Second Revenue Act of 1940, 76th Cong. 3d Sess. (1940) 124, 125. Yet Congress provided for their amortization over a period of five years. When the War Production Board attempted to limit to 35% the proportion of the cost which could be so amortized, it was, in effect saying that the actual cost could be amortized, during the first five years, only to the degree which would contemplate its total amortization in about fifteen years. That was a contradiction of the statute. The Board, as we have seen, decided upon the 35% figure because that was its estimate of the excess cost of acquiring the facilities in wartime. But there is no suggestion in the statute or its legislative history that such a consideration had any relevance. The purpose of the statute was to induce private enterprises to acquire facilities for which they would have had no need, except for the pressure of wartime production. According to the Board's reasoning, if price and wage controls had kept the wartime cost of the facilities down to the peacetime cost, no use whatever would have been made of Section 124. But an enterprise does not spend its money to acquire unneeded facilities, or those which will be needed for only a short time, just because it can acquire them at normal prices.

We think that the Board's only function was to determine whether or not facilities answered the description of the statute, i. e., were they "necessary in the interest of national defense during the emergency period." Having so determined, any attempt by the Board to reduce the benefits which Congress granted to the person whose facilities answered the description, was in violation of the statute. The Government suggests that if the Board could not have limited its certificate to 35% of the costs of the facilities, it would, perhaps, not have certified them at all. We have no reason to suppose that the Board, when applied to by the plaintiff for a factual statement as to whether the plaintiff's facilities were, or were not "necessary in the interest of national defense during the emergency period," would have said to itself, "If we make a true statement, it will cost the Government X dollars in lost revenue. If it would cost the Government only Y dollars, we would tell the truth. But since it will cost X dollars, we will not tell the truth."

The Government points to the language of Section 124 (f), hereinbefore quoted which says that there shall be included for rapid amortization purposes "only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction * * * or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary, etc." The Government says that this language authorized the certifying authority to certify only a part of the cost of the facilities, in his discretion. We think that this is a misreading of the statute. Subsection (e) (1) of Section 124, in defining the term "emergency facility" gives a somewhat complicated formula for determining the time at which the facility must have been acquired in order to be eligible for accelerated amorti-

zation. Apparently December 31, 1939, was the date after which, in any event, the facility must have been acquired in order to be so eligible. But even if acquired after that date, application for a necessity certificate had to be made within six months after its acquisition. And if some of the facility was acquired more than six months before the date of application, and the rest within six months, the latter amount would be eligible. Thus the words "only so much of, etc." are needed, and have a rational application without construing them as authorizing the certifying authority to contradict the purpose of the statute.

As to the facilities acquired before July 17, 1944, the problem is somewhat different. It will be remembered that the plaintiff applied for its certificate of necessity on all of its facilities on May 29, 1944. The earliest date at which it had acquired any of the facilities was December 28, 1943, so that its application was within six months of the acquisition. On July 17, 1944, the Board wrote the plaintiff that it had made a determination that all the facilities were necessary in the interest of national defense, provided the date of their acquisition was subsequent to the date of the letter. The Board requested the information, in affidavit form, hereinbefore described, and, having received it, issued its certificate, attaching the entire list, but having crossed out the items which were acquired before July 17, 1944.

The Government points to Section 124 (f) (1) which says that one gets accelerated amortization upon facilities which either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense. It says that as to the facilities acquired before July 17, 1944, no certificate was issued, and that's the end of it. No certificate, no amortization. Since the Board's letter

of July 17 stated that all the facilities listed were necessary, and since the plaintiff's application for its certificate was filed within the six months statutory period, the question arises, of course, why the Board refused to issue the certificate upon at least the 35% basis.

On March 22, 1944, the Board, with the approval of the President, issued the following regulation (8 Fed. Reg. 2492, March 4, 1944):

> Section 4. *Application must be filed and determination made before construction is begun or date of acquisition.* The construction, reconstruction, erection, installation, or acquisition of a facility will not be deemed necessary within the terms of these regulations unless a determination of necessity is made by the certifying authority prior to the beginning of the construction, reconstruction, erection, installation, or date of acquisition.

The plaintiff contends that the regulation is invalid. When Section 124 was originally enacted, in the Second Revenue Act of 1940, approved October 8, 1940, subsection (f) (3) provided that a certificate of necessity would be ineffective unless obtained before the facility was acquired. By Joint Resolution approved January 31, 1941, subsection (f) (3) was amended to provide that certificates of necessity would be valid if applications for them were made within sixty days after the acquisition of the facility. Again, in October 1941, by House Joint Resolution 235, Public Law 285, 77th Cong., 1st Sess. Ch. 464, Congress again amended subsection (f) (3) and enlarged the period within which application for a certificate might be filed from sixty days to six months after the acquisition of the facility.

Congress having specifically and repeatedly dealt with the question of when applications might be filed, and having each time enlarged the period, we think that the regulation quoted above, which in effect discarded the amendments made by Congress and put into effect the requirements of the original statute, was invalid. We think, therefore, that the plaintiff having applied within six months for its certificate, it was the duty of the certifying officer to determine the fact as to whether the facilities were necessary in the interest of national defense, and to certify or refuse to certify accordingly. The Chairman of the Board did determine that the facilities were necessary, and issued the letter of July 17 so saying. He then refused to issue the formal certificate solely because of the regulation which we have said above was invalid. He having put his mind upon the question of fact, which we think was his only function under the statute, and having answered that question in favor of the plaintiff, it was his duty to issue the certificate, and we feel certain that he would have done so but for the invalid regulation. His refusal, therefore, amounted in law, though not in fact, to an arbitrary refusal to perform his statutory duty. We have no reason to suppose that the enormous tax benefits which Congress, wisely or not, sought to confer by the enactment of Section 24 were to be bestowed or withheld at the arbitrary will of the executive. Equity regards that as done which ought to have been done. We do not have here the problem of deciding, contrary to the decision of the official in which the statute lodged the power of decision, that the facilities in question were necessary. He decided that they were. We merely append the proper legal consequences to his decision by disregarding the invalid regulation which prevented him from putting his factual decision in legal

form. We conclude, therefore, that the facilities acquired by the plaintiff before July 17, 1944, were eligible for accelerated amortization, and that the plaintiff is entitled to that amortization.

Substantially the same questions involved in the instant case were presented to the United States District Court for the District of Columbia in *The United States Graphite Co.* v. *Secretary of Commerce,* 71 F. Supp. 944. That was a suit by the plaintiff's predecessor, the Graphite Company, to compel the issuing authority to issue the certificates of necessity which would have entitled that company to the tax deductions which the plaintiff claims here. The District Court, Judge Pine sitting, denied relief. The United States Court of Appeals affirmed, 176 F. 2d 868, upon the opinion of Judge Pine. Judge Wilbur K. Miller of the Court of Appeals dissented, in an opinion with which we agree. The Supreme Court denied certiorari. 339 U. S. 904. The Government does not claim that the litigation made the dispute a *res adjudicata.* In the circumstances we are, naturally, skeptical of the correctness of our conclusions.

The plaintiff is entitled to recover. Entry of judgment will be suspended to await the filing by the parties of a stipulation showing the amount due the plaintiff, according to our findings and opinion.

It is so ordered.

HOWELL, *Judge;* WHITAKER, *Judge;* and LITTLETON, *Judge,* concur.

JONES, *Chief Judge,* dissenting in part.

I agree that plaintiff should recover but the amount should be limited to 35 percent of the cost of the facilities.

I think the provision of Section 124 (f) (1) of the Internal Revenue Code which is as follows:

> (1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such * * * acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President. * * *

clearly authorized the executive officials to limit the amount of the amortization. *United States Graphite Co.* v. *Harriman,* 71 Fed. Supp. 944. *United States Graphite Co.* v. *Sawyer,* 176 F. 2d 868 (*certiorari denied*).

U. S. GOVERNMENT PRINTING OFFICE: 1956

[redacted] STATES OF AMERICA, *Petitioner*,

v.

[redacted] ALLEN-BRADLEY COMPANY

[redacted]

[redacted]

# BRIEF FOR THE ALLEN-BRADLEY COMPANY


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IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1956

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**No. 78**

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UNITED STATES OF AMERICA, *Petitioner*

*v.*

THE ALLEN-BRADLEY COMPANY

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**On Writ of Certiorari to the United States Court of Claims**

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## BRIEF FOR THE ALLEN-BRADLEY COMPANY

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### OPINION BELOW

The opinion of the Court of Claims (R. 14-15) has not been officially reported.

### JURISDICTION

The order of the Court of Claims granting taxpayer's motion for summary judgment was entered on April 3, 1956 (R. 14-15). The petition for a writ of certiorari was filed on May 3, 1956, and was granted on June 11, 1956 (R. 15). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

## QUESTIONS PRESENTED

1. Whether under Section 124 of the Internal Revenue Code of 1939 a taxpayer, for purposes of computing amortization deduction, is entitled to include in its "adjusted basis" the entire cost of World War II facilities certified by the certifying authority to be "necessary in the interest of national defense", or only such percentage of the cost of the facilities as the certifying authority prescribed on the basis of his assumptions as to the facilities' post-World War II utility.

2. Whether this Court should consider an issue not raised by the Government in the court below, but raised for the first time in the Government's petition for a writ of certiorari, to the effect that the taxpayer is barred from challenging the power of the certifying authority under Section 124 of the Internal Revenue Code of 1939 in prescribing that only a percentage of the cost of facilities certified to be "necessary in the interest of national defense" shall be included in the taxpayer's "adjusted basis" and eligible for tax amortization.

## STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Statutes and Regulations involved are Sections 23(t), 124(a), (d), (e), (f), and (g), and 124A of the Internal Revenue Code of 1939, and Section 29.124-6 of Treasury Regulations 111. The pertinent portions of said statutes and said Regulations are set forth in the Appendix, *infra.*

## STATEMENT

There is no dispute over the material facts in this case. The facts as alleged in the taxpayer's Petition (R. 1-11), and as admitted in the Government's Answer (R. 11-12),

upon the basis of which the Court of Claims granted the taxpayer's motion for summary judgment (R. 14-15), may be summarized as follows:

During World War II, the taxpayer, a Wisconsin corporation, was engaged in the manufacture of motor controls, radio resistors, and radio parts, which were in short supply at the time. Directly and indirectly substantial quantities of the taxpayer's products were used by the Navy Department, the War Department, and the Maritime Commission in various types of equipment used in the prosecution of the war. (R. 3, 11.)

Because of the critical supply of electric motor controls, radio resistors, and radio parts, and the immediate need therefor in the prosecution of the war, Government procurement officers requested the taxpayer to increase its production of said products. In order to increase its production, it was necessary for the taxpayer to almost continuously enlarge its plant and to purchase and/or construct additional machinery and equipment. (R. 3, 11.)

During the period 1940 to 1945, inclusive, and in connection with such expansion, the taxpayer filed for and was issued nine Certificates of Necessity pursuant to the provisions of Section 124 of the Internal Revenue Code of 1939. In each and every instance the duly designated certifying authority certified the emergency facilities described in the application for a Certificate of Necessity filed by the taxpayer as being necessary in the interest of national defense. However, in three instances the certifying authority prescribed a limitation on the proportion of the cost amortizable under Section 124 of the 1939 Code with respect to the facilities described in and covered by the Necessity Certificate. The procedure in prescribing less than 100 percent of the cost of the facilities as amortizable under Section 124 was in accordance with

an unpublished policy adopted by the certifying authorities of attempting to limit amortization to less than the full cost of the facilities where they were presumably adaptable to post-war operations.[1] (R. 3-4, 11.) In this connection, Mr. John L. Lincoln, Chief of Section Two of the Amortization Branch of the Procurement Policy Division of the War Production Board, in a letter to the taxpayer dated March 20, 1945, concerning Necessity Certificate NC-8542 that had been issued to it, stated (R. 4.):

> "The above application is in course of approval for 35% certification, rather than full certification as requested in your transmittal letter of February tenth, inasmuch as all of the facilities appear to be standard machine tools usable for production of a variety of peace-time articles, not special tools usable only for specific war production for which you propose to use them."

The first of the three Certificates in question is Necessity Certificate WD-N-27705 as amended by Necessity Certificate WD-N-27705-A. On November 30, 1943 the Secretary of War issued Necessity Certificate WD-N-27705 certifying that the facilities described in the taxpayer's application were "necessary in the interest of Na-

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[1]The Court's attention is directed to what is considered a misleading statement in the Government's Statement of Facts in its brief (pp. 3-4) where it states:

> "In each instance the duly designated certifying authority determined that facilities described in taxpayer's application were necessary in the interest of national defense; however, *in three instances the certifying authority certified that only part of the cost of such facilities was necessary for the national defense.*" (Emphasis supplied.)

Suffice it to say that in all three instances the certifying authority certified the facilities as being necessary *in their entirety* in the interest of national defense. The refusal to prescribe 100 percent of the cost of the facilities as amortizable under Section 124 was attributable to the fact that said facilities, in the *opinion* of the certifying authority, possessed post-World War II utility.

tional Defense during the emergency period up to 25% of the cost attributable to the construction, erection, installation or acquisition thereof * * * ." The taxpayer returned Necessity Certificate WD-N-27705 to the Secretary of War, informing him that the terms of the Certificate certifying only 25 percent of the cost of the facilities as amortizable under Section 124 of the Internal Revenue Code of 1939 were unacceptable to it, and, therefore, that it was unwilling to proceed with the project for which it intended to use the facilities. Thereafter, Necessity Certificate WD-N-27705-A was issued amending Necessity Certificate WD-N-27705 by striking out the "25%" of the cost and in lieu thereof substituting "80%" of the cost. The facilities covered by Necessity Certificate WD-N-27705 as amended by Amendatory Necessity Certificate WD-N-27705-A were constructed, purchased, and installed at a cost of $1,014,930.34. (R. 5-6, 11.)

The second Certificate, NC-2631, was issued to the taxpayer on March 30, 1944 certifying that the machinery and equipment described in the taxpayer's application was "necessary in the interest of National Defense during the emergency period up to 85% of the cost attributable to the construction, reconstruction, erection and installation or acquisition thereof * * * ."[2] The facilities covered by this Certificate were purchased and installed at a cost of $125,990.28. (R. 6-7, 11.)

The third Certificate, NC-8542, was issued to the taxpayer on February 13, 1945, certifying that the facilities

[2]In Appendix A to the Application as originally filed by the taxpayer, there was listed machinery and equipment having a total estimated cost of $274,600.00. The certifying authority, however, deleted certain of the machinery and equipment therein listed as being unnecessary in the interest of national defense and the machinery and equipment described in Appendix A to Necessity Certificate NC-2631 had an estimated cost of $271,310.00. (R. 6.)

described in the taxpayer's application, as amended, "are necessary in the interest of National Defense during the emergency period up to 35% of the cost attributable to the acquisition thereof provided such facilities are received prior to July 15, 1945." The facilities covered by this Certificate were purchased and installed at a cost of $38,913.75. (R. 7, 11.)

The language contained in the above described Necessity Certificates is in all material respects identical (except as to prescribed portions of amortizable cost) to the language contained in the Necessity Certificates issued to the taxpayer in *Wickes Corp. v. United States,* 108 F. Supp. 616 (C. Cls.), and *Ohio Power Co. v. United States,* 129 F. Supp. 215 (C. Cls.), certiorari denied 350 U. S. 862, rehearing denied, 350 U. S. 919, motion for leave to file petition for rehearing denied, 351 U. S. 958, order denying petition for rehearing vacated, June 11, 1956 (No. 312, Oct. Term 1955). (R. 8, 11.)

In accordance with the provisions of Section 124 of the Internal Revenue Code of 1939, the taxpayer duly elected to take amortization deductions with respect to all of its emergency facilities over a period which began with the month following their acquisition. The taxpayer later elected to terminate the amortization period as of September 30, 1945, pursuant to the Presidential Proclamation declaring that the period of emergency was to be considered terminated as of that date. (R. 8-9, 11-12.)

Although the certifying authorities had certified *all* the facilities covered by these three Certificates as being necessary in the interest of national defense, on its 1944 and 1945 fiscal year tax returns the taxpayer computed its amortizable deductions on the facilities giving effect to

the percentage of cost limitations prescribed in the three Certificates. Within the time required by law, and on March 30, 1953, the taxpayer filed Claims for Refund in which it alleged that it overpaid its taxes for both the years 1944 and 1945 by reason of its failure to have used 100 percent of the cost of the facilities covered by these three Certificates in the computation of its amortization deductions under Section 124. (R. 9-10, 12.)

On November 12, 1954 the Commissioner of Internal Revenue rejected the Claims for Refund filed by the taxpayer for the years 1944 and 1945. Thereafter, and on July 22, 1955, the taxpayer filed a petition in the court below for a refund of $178,327.75 in excess profits taxes and declared value excess-profits tax paid for the years 1944 and 1945, plus statutory interest thereon, claiming that the Commissioner had erred in failing to allow it amortization deduction under Section 124 of the 1939 Code for said years on the basis of the full cost of the facilities described in and covered by three Necessity Certificates, and determined by the duly authorized certifying authorities to be, in their entirety, necessary in the interest of national defense. (R. 1-11.) Since there was no material issue of fact involved, the court below granted taxpayer's motion for summary judgment, relying upon its prior determinations of the same question in *Wickes Corp. v. United States, supra,* and *Ohio Power Co. v. United States, supra.*

## SUMMARY OF ARGUMENT

### I.

The fundamental issue involved in this case is whether Subsection (f) (1) of Section 124 conferred upon the certifying authority (1) the *single power* to certify that the construction or erection of certain facilities was "necessary in the interest of national defense", or (2) the *dual power* to certify (a) that the construction or acquisition of facilities was necessary in the interest of national defense, and (b) to prescribe the percentage of cost of said facilities subject to rapid tax amortization based upon the certifying authority's assumptions as to the facilities' post-World War II utility. The taxpayer contends that the Court of Claims correctly held, relying upon its prior determinations in *Wickes Corp. v. United States,* 180 F. Supp. 616, and *Ohio Power Co. v. United States,* 129 F. Supp. 215, that Subsection (f) (1) of Section 124 conferred upon the certifying authority the single power to determine whether facilities were necessary in the interest of national defense, and if so certified, it necessarily followed that the entire (100%) cost of said facilities was eligible for rapid tax amortization during the emergency period.

The language used in Section 124, and in particular in Subsection (f) (1) of Section 124, is clear and unambiguous. It directs that there be included in the "adjusted basis" and eligible for amortization the cost of facilities " * * * certified as necessary in the interest of national defense * * * ". Congress recognized, however, that the facilities could be certified as necessary where construction or acquisition was started prior to December 31, 1939, but completed after that date, and, to avoid

retroactive amortization in such cases, it provided in Subsection (f) (1) that there was to be included in the taxpayer's "adjusted basis" and eligible for amortization only so much of the cost of the facilities as was properly attributable to "such construction, * * * or acquisition after December 31, 1939 * * * ". Insofar as the certifying authority is concerned, it merely conferred upon him the power to certify whether the construction or acquisition of the physical facilities was necessary. On the other hand, the statute expressly empowered the Commissioner of Internal Revenue to determine the portion of the cost attributable to construction or acquisition after December 31, 1939. No other mention of cost is contained in the statute. Consequently, there is no reason to assume, contrary to the Government's contention, that Congress intended to grant the certifying authority *or* the Commissioner the power to determine that less than 100 percent of the cost of facilities certified as necessary and constructed after December 31, 1939 was includible in the taxpayer's "adjusted basis" and eligible for amortization merely because they were of the opinion that the facilities possessed post-World War II utility. Indeed, the Government is in effect requesting this Court to give Section 124 a strained and unwarranted construction or, in other words, it is advocating judicial legislation.

If any doubt exists after reading Subsection (f) (1) of Section 124 as to its true meaning, that doubt is completely dispelled by a review of its legislative history, and an analysis of the conditions surrounding its enactment. The Second Revenue Act of 1940, which added Section 124 to the Code, was enacted at a time when the United States was launching into a defense program requiring a large-scale expansion of its production facili-

ties, and contained therein three inter-related features each of which was important to the financial aspect of the program: (1) A corporation excess profits tax; (2) suspension of the profit limitations under the Vinson-Trammill Act; and (3) a special amortization program with respect to defense facilities. The special amortization provision was designed to encourage the investment of private capital in defense production facilities. The various members of the Executive Branch of the Government who appeared before Congressional Committees to urge the enactment of Section 124 indicated that they were aware of the fact that in many instances the facility certified as necessary in the interest of national defense, and eligible for rapid tax amortization, would possess post-war utility. Nonetheless, their testimony indicates that they felt there were over-riding considerations which made it both desirable and prudent to allow a 100 percent amortization of facilities determined to be necessary in the interest of national defense.

It is only reasonable to conclude, based upon an examination of the House and Senate Reports, that Congress adopted *in toto* the views expressed by the various members of the Executive branch of the Government who appeared before Congressional Committees to urge the enactment of Section 124. Nowhere in said Reports is there any indication that Congress intended to confer upon the certifying authority anything more than the power to determine which facilities were necessary in the interest of national defense. On the contrary, it is implicit in said Reports that Congress intended to so limit the certifying authority's power.

Finally, support for the position of the Court of Claims in the *Wickes, Ohio Power,* and *Allen-Bradley* cases is to be found in the language contained in Section 124A

which was added to the Code by the Revenue Act of 1950. In sharp contrast to Section 124, Congress in Section 124A bestowed upon the certifying authority the power to issue percentage certificates where, in the certifying authority's opinion, the facilities possessed post-Korean War utility. Under the circumstances, the correctness of the Court of Claims' interpretation of Subsection (f) (1) of Section 124 in the *Wickes Corp., Ohio Power,* and *Allen-Bradley* cases is confirmed not only by a review of the clear and intent language of the statute, but also its pre-legislative and post-legislative histories.

## II.

The Government contends that the taxpayer has failed to timely challenge the certifying authority's lack of power to determine that only a percentage of the total cost of facilities certified as necessary in the three Certificates of Necessity, subject of dispute, was includible in the "adjusted basis" for purpose of computing the amortization deduction permitted under Section 124 of the 1939 Code. Since the first time that the Government raised this defense was in its petition for a writ of certiorari, taxpayer submits that it has not been timely raised and, therefore, should not be considered by this Court.

Waiver, estoppel and collateral attack are defenses which must be pleaded affirmatively. See Paragraph (b) of the Rules of the Court of Claims. The requirement that affirmative defenses must be pleaded or raised in the court of original jurisdiction is a well-established rule of civil procedure, and if not strictly adhered to it would only serve to further burden our already over-burdened Federal Court system. Under the circumstances, this Court should apply the rationale of its decisions in *General Utilities Co. v. Helvering,* 296 U. S. 200, and *Hel-*

*vering v. Salvage,* 297 U. S. 106, and refuse to consider the question as to whether the taxpayer timely challenged the certifying authority's power, or lack of power, to prescribe the percentage of cost that is amortizable, after having determined that the facilities covered by the three Necessity Certificates in question were, in their entirety, necessary in the interest of national defense.

## ARGUMENT

### I.

### Under Section 124 Of The Internal Revenue Code Of 1939 The Entire Cost Of The World War II Facilities Certified As Being "Necessary In The Interest Of National Defense" Under The Three Necessity Certificates In Question Was Includible In The Taxpayer's "Adjusted Basis" And Eligible For Rapid Tax Amortization.

### A. Preliminary

It is apparent from the outset that there is a basic dispute as to what constitutes the fundamental issue involved in this case. It is the taxpayer's contention that the fundamental issue involved is whether Congress under Section 124(f)(1) of the Internal Revenue Code of 1939 (Appendix, *infra*) conferred upon the certifying authority[3]:

(1) The *single power* to certify that the construction or acquisition of facilities described in the taxpayer's application for a Certificate of Necessity was "necessary in the interest of national defense", or

[3]From 1940 to December 17, 1943, the certifying authorities were the Secretary of War and Navy, when the President, by Executive Order 9406 (8 FR 16955) transferred the function as to all future applications for Certificates of Necessity to the War Production Board.

(2) The *dual power* (a) to certify that the construction or acquisition of facilities described in the taxpayer's application for a Certificate of Necessity was necessary in the interest of national defense, and (b) to prescribe the percentage of the cost of the facilities subject to being amortized for tax purposes during the emergency period of World War II, such percentage being determined on the basis of the facilities assumed or lack of assumed post-World War II utility.

The Government, on the other hand, contends that the single issue involved is whether Congress conferred upon the certifying authority the power to certify the percentage of the cost of facilities that was "necessary in the interest of national defense", and, therefore, the percentage of cost eligible for rapid tax amortization. Apparently the Government desires to overlook the fact that in its Answer (R. 11) it admitted to be true and correct the following allegation of fact contained in the Petition (R. 4):

"(c) In connection with such expansion and pursuant to the provisions of Section 124 of the Internal Revenue Code of 1939, the plaintiff filed for and was issued nine Necessity Certificates. *In each and every instance the duly designated certifying authority determined that the facilities in the plaintiff's application for a Necessity Certificate were necessary in the interest of national defense.* However, in three instances the duly designated certifying authority certified less than one hundred percent (100%) of the cost of the facilities described in and covered by the Necessity Certificate as amortizable under Section 124 of the Internal Revenue Code of 1939. The refusal to certify the entire cost of the facilities as amortizable under Section 124 of the Internal Rev-

> enue Code of 1939 was in accordance with a policy which had been established of not permitting full amortization where the facilities were presumed adaptable to post-war operations." (Emphasis supplied.)

In other words, irrespective of what the Government may contend, the fundamental issue involved in this case is whether under Section 124 Congress conferred upon the certifying authority not only the power to certify that certain facilities were "necessary in the interest of national defense", but, in addition, the power to prescribe the percentage of the cost of said facilities that was eligible for rapid tax amortization *if in the opinion of the certifying authority the facilities possessed post-World War II utility.*

The taxpayer submits that the Court of Claims correctly held (R. 14-15) that under Subsection (f) (1) of Section 124 Congress conferred upon the certifying authority the *single power* to determine whether the construction or acquisition of the physical facilities described in a taxpayer's application for a Certificate of Necessity was "necessary in the interest of national defense", and, if so certified, it necessarily followed that the entire cost of said facilities was eligible for rapid tax amortization during the World War II emergency period. As support for its position, the taxpayer relies first on the wording of Subsection (f) (1) of Section 124, which it claims is clear and unambiguous, and then upon the legislative history of Section 124, and the language as used in Section 124A as added to the 1939 Code by the Revenue Act of 1950.

**B. When the language contained in Subsection (f) (1) of Section 124 is given its ordinary and usual meaning it conferred upon the certifying authority the single power to determine whether facilities were necessary in the interest of national defense.**

It is a well established rule of statutory construction that resort need not be had to extrinsic aids where the words of a statute are clear and unambiguous. See *Burnet v. Guggenheim,* 288 U. S. 280; *Old Colony R. R. Co. v. Commissioner,* 284 U. S. 552; *United States v. Merriam,* 263 U. S. 179. With this rule in mind, we turn to examine Section 124, and in particular Subsection (f) (1) of Section 124, with which we are here concerned.

Section 23(t) of the 1939 Code (Appendix, *infra*) permits, in the computation of net income, "the deduction for amortization provided in Section 124", and said Section 124 permits a deduction with respect to the amortization "of the adjusted basis" of "any emergency facility" based on an amortization period of sixty months. Section 124(d) provides, however, that the sixty-month period of amortization could, on the earlier termination of the emergency period by the President, be shortened, thus permitting larger annual deductions over a shorter period of time. An "emergency facility" is defined in Section 124(e) as "any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, installation or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made". Subsection (f) of Section 124, which con-

tains the crucial language insofar as this case is concerned, provides:

> *"Determination of Adjusted Basis of Emergency Facility.* — In determining, for purposes of subsection (a) or subsection (b), the adjusted basis of an emergency facility —
>
> (1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President."

On analysis, we submit that the meaning of the above language is clear and unambiguous. It directs that for amortization purposes there be included in the "adjusted basis" only so much of the total cost as is properly attributable to "such construction, * * * or acquisition after December 31, 1939, as either * * * Secretary * * * has certified as necessary in the interest of national defense * * *." It does not direct that there be included in the adjusted basis *only so much (such proportion) of the cost of* such construction or acquisition as the Secretary has certified as necessary. On the contrary, the certifying power granted to the Secretary merely goes to making a determination as to "such construction or acquisition * * * as necessary", with no mention or reference to cost or percentage of cost in terms of being necessary. In other words, to arrive at the interpretation of Section 124(f)(1) for which the Government con-

tends one must read the words "only so much of the cost of" into the statute prior to "such construction" or possibly strike the word "such" immediately preceding "construction * * * or acquisition".

Section 125(f)(1) is a tax statute, and empowered the certifying authority to determine only whether "such construction * * * or acquisition" of the facilities was necessary, reserving to the Commissioner of Internal Revenue all other functions, such as that of determining when the construction or acquisition occurred. See *American Twist Drill Company v. Commissioner,* 11 T. C. 200.[4] Had Congress intended to grant the certifying authority the broad powers that the Government contends were granted to it, then it would have been only logical for Congress to have granted the certifying authority the power to determine what percentage of construction or acquisition of the emergency facilities took place after December 31, 1939. The fact that Congress directed the Commissioner to allow taxpayers amortization deductions for only so much of the "adjusted basis" as *he* determined to have resulted from the construction or acquisition of emergency facilities that took place after December 31, 1939 is evidence, we submit, that Congress intended to limit the power of the certifying authority to certify whether such construction or acquisition was "necessary in the interest of national defense".

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[4]In the *American Twist Drill Company* case, the certifying authority acting under Section 124 duly issued a Certificate of Necessity to cover the taxpayer's facilities. Nevertheless, the Commissioner refused to give effect to the Certificate holding that under the proper interpretation of Section 124, construction of taxpayer's facilities had begun more than six months before it filed its application for the Certificate. The Tax Court approved the Commissioner's determination. Compare: *Arkansas Oklahoma Gas Co. v. Commissioner,* 17 T. C. 1208.

The Government Brief is replete with statements as to what Congress must have intended (Br. 26-47). It suggests (Br. 29) that Congress could not "have intended to require the determinations of necessity be made on an abstract, mechanical, '100 percent or nothing' basis". The Government continues —

> *"It is not reasonable to assume, in the absence of express language to the contrary,* that Congress, under the circumstances, deliberately withheld from the certifying officials the authority to decide, on the basis of all relevant considerations, that a part, but not all, of the cost of a particular plant was necessary for the national defense, and that a certificate of necessity should be issued for only that part of the cost. On the contrary, we think the statutory provisions quoted above amply empower the agencies to exercise such a judgment." (Emphasis supplied.)

The absurdity of the Government's position is, we believe, obvious. In short, what reason is there to assume that Congress intended to grant the certifying authority the power to determine that less than 100 percent of the cost of facilities certified to be necessary was eligible for rapid tax amortization, when, in the opinion of the certifying authority, they possessed post-war utility? The obvious answer is none.

In this connection, it should be emphasized that the persons entrusted with authority to determine what facilities were necessary for defense purposes had the single duty, and required information, to determine what products were needed for defense, how such products could be fabricated, what facilities were needed for fabrication, how many of such facilities were in existence, so as to enable them to determine facilities in short supply. In process of such determination, they acquired no special

knowledge as to probable post-war conditions such as to enable them to gauge the degree of usability of required defense facilities in the post-war world.

As the above indicates, the Government is requesting this Court to give Section 124 a strained and unwarranted construction. In effect, the Government is advocating judicial legislation by this Court. Under subsection (f) (1) of Section 124 as correctly interpreted, the certifying authority was granted the single power to determine whether the construction or erection of certain facilities was "necessary in the interest of national defense", and if so certified *a fortorari* their entire cost was includible in the "adjusted basis" and eligible for rapid tax amortization unless the Commissioner (as distinguished from the certifying authority) determined that a portion of the cost of the facilities was attributable to *certified* construction or acquisition which took place before December 31, 1939. Suffice it to say that the taxpayer is of the view that resort need not be had to the legislative history of Section 124 in order to ascertain its correct interpretation.

**C. The legislative history of Section 124 provides cumulative support for taxpayers' contention that Subsection (f)(1) of Section 124 merely conferred upon the certifying authority the single power to determine whether facilities were necessary in the interest of national defense.**

Assuming *arguendo* that after reading Subsection (f) (1) of Section 124 there is doubt as to its true meaning, that doubt is completely dispelled by a review of its legislative history. Indeed, the passages which are quoted from the legislative history of Section 124 in the Government's Brief (Br. 41, 42-43) show that it was correctly

interpreted by the Court of Claims in *Wickes Corp. v. United States,* 180 F. Supp. 616, and *Ohio Power Co. v. United States,* 129 F. Supp. 215, certiorari denied, 350 U. S. 876, rehearing denied, 350 U. S. 919, motion for leave to file petition for rehearing denied, 351 U. S. 958, order denying petition for rehearing vacated, June 11, 1956 (No. 312, Oct. Term 1955), and by the Tax Court in *National Lead Co. v. Commissioner,* 23 T. C. 988, 1002, reversed on other grounds, 230 F. 2d 161 (C. A. 2nd), certiorari granted, 351 U. S. 981 (No. 124, this term).

Section 124 was added to the Internal Revenue Code of 1939 by the Second Revenue Act of 1940, C. 757, 54 Stat. 974. As the Government indicates (Br. 14), that Act was added at a time when the United States was launching into a defense program of unprecedented magnitude requiring a large-scale expansion of its production facilities and contained therein inter-related features, each of which was important to the financial aspects of the program—(1) a corporation excess profits tax designed to raise revenue as well as to prevent an inflationary spiral and excessive profiteering at the expense of the Government; (2) suspension of the profit limitations under the Vinson-Trammill Act relating to construction or manufacture of naval vessels and Army and Navy aircraft; and (3) a special amortization program with respect to defense facilities which was designed to encourage the investment of private capital in the defense program. H. Rep. No. 2894, 76th Cong. 3d Sess. pp. 1-2 (1940-2 Cum. Bull. 496).

The special amortization provisions were designed to encourage the investment of private capital in defense production facilities. Treasury officials and Congress recognized that it was impossible to expect taxpayers with private capital to invest in production facilities that

would have been useless in the depression just ended, and that could, in their opinions, very well be useless (in terms of duplicating already existing facilities) once the war production program had been fulfilled. They also recognized that the excess profits tax provisions contained in the Revenue Act of 1942, which they were sponsoring, were specifically designed to capture all income above "normal", or, in other words, all corporation income in excess of their average income for the years 1936-1939, or all income in excess of a moderate percentage return on invested capital. How could Congress encourage successful businesses to risk their capital in the expansion or duplication of production facilities, when any profit increases would be captured by the Government as excess profits taxes? How could successful businesses finance payment for defense production facilities without the retention of the income from such facilities? The answers to these questions, in the opinion of Treasury officials and Congress, laid in allowing special amortization of the cost or amount invested in defense production facilities. While the excess profits tax provisions would prevent increased wartime profits, by reason of the special amortization provisions contained in Section 124, businesses would, at the close of the defense period, have new facilities, fully paid for (through tax savings) which would, if adaptable to post-war use and *if* the demand existed, be usable in the post-war operations. In brief, the amortization provision included the calculated possibility that these new facilities were usable after the War, as an incentive to businesses providing risk capital for construction of the facilities. Any doubt that Congress and Treasury officials did not anticipate a post defense period use should be removed when it is appreciated that land, an indestructible item of perpetual use, was included for rapid tax amortization purposes. How could land avoid having some post-war utility?

Various members of the Executive Branch of the Government appeared before Congressional Committees to urge the enactment of what was to become Section 124 of the 1939 Code.[5] A review of the testimony given by these persons reveals that they were aware that in many, if not most, instances the facilities certified as necessary in the interest of national defense, and eligible for rapid tax amortization, would possess post-war utility, i.e., would not be totally obsolete at the time the emergency was over. In view of the need for providing incentives, it was their considered opinion that those facilities should be eligible for rapid tax amortization. For example, Assistant Secretary of the Treasury, John L. Sullivan, testified (Senate Finance Committee Hearings on Second Revenue Act of 1940, 76th Cong. 3d Sess. pp. 124-125):

> "Senator Vandenberg. If their expected useful life is the existence of the emergency, why wouldn't you be entitled to make a contract of that sort with them?
>
> "Mr. Sullivan. We don't know that that is the expected useful life. *There are certain facilities that are being constructed for purely national-defense projects, which may be just as useful after the war is over, or the present emergency is over, or the particular contract they are built to perform is over, as they are during the time that contract is being performed.* (Emphasis supplied)
>
> * * *
>
> "Senator George. Just a minute, Mr. Sullivan. You say it is necessary for them to certify that it is necessary to national defense. Do they stop there?

[5]The Treasury was of the opinion that it merely had the authority to allow "reasonable" depreciation and did not have the power to allow deductions for special amortization. Accordingly, the Treasury desired, as part of the national defense program, that Congress enact a statute bestowing power upon it to allow deductions for amortization of facilities determined necessary in the interest of national defense. See testimony of John L. Sullivan, Senate Finance Hearings on Second Revenue Act of 1940, 76th Cong. 3d Sess., pp. 124-126.

"Mr. Sullivan. I beg your pardon?

"Senator George. *Is the certificate that is issued on the recommendation of the National Council and the Secretary of War or Navy, as the case may be, limited to mere certification that the particular facility is necessary for defense, or do they go further and specify what the depreciation and obsolescence amounts to?* (Emphasis supplied)

"Mr. Sullivan. *No; they do not.* (Emphasis supplied)

"Senator George. They turn that back to the Treasury?

"Mr. Sullivan. *No sir; under the bill automatically the amortization to which they are entitled is 20 percent a year, for 5 years."* (Emphasis supplied)

Mr. Sullivan also testified (p. 125):

"Senator George (interposing). You want Congress, then, to say that it is going to be all obsolete and all pass out in 5 years, but you are not willing to take that responsibility?

"Mr. Sullivan. I don't want Congress to say that at all.

"Senator George. That is what you are doing.

"Mr. Sullivan. I beg your pardon, sir. This bill says that in view of the present emergency and our necessity of speeding up these orders, and to encourage them, they must confer this special privilege which cannot be granted under the present law.

"Senator George. I take issue with you on it, but that is probably a moot question if you are going to put it in the law that they should be allowed 20 percent. But if it is reasonable to allow depreciation of 20 percent per year on a facility constructed to meet this national emergency, and if it is reasonable

to make an allowance for obsolescence, the Treasury has the authority to do it.

"Mr. Sullivan. That is correct, but I think we are using 'reasonable' in two different ways, Senator George.

"Senator George. I don't think so.

"Mr. Sullivan. Under this law, it may be prudent, it may be the wise thing to do; but I couldn't say to this committee that it is reasonable to expect that an ultra-modern factory that is to be constructed in the latter part of 1940 or the first part of 1941, built with all of the latest skill and engineering experience, is going to be absolutely useless in 1946. I don't think that is 'reasonable', and yet I believe it is desirable and prudent to grant this amortization to those companies that are putting up new facilities for this picture.

"Senator George. *It may not be reasonable under the amortization section in this bill to reach that conclusion. It may be that that facility will have a use after the passing of the emergency. That is true. But we are saying here in the law that nevertheless it should be written off.* (Emphasis supplied)

* * *

"Senator George. We take it to be your judgment on that question that these added facilities are going to become either what we now call for lack of better term, in 'obsolescence' or that the depreciation is going to absorb all the value within the statutory period that follows the issuance of this certificate.

"Mr. Sullivan. *Excuse me, Senator George, that is not our judgment. We don't know that they are. We are saying that regardless of whether or not they do, it is prudent and wise to confer this special privilege of assuming that they are going to*—(Emphasis supplied)

"Senator George (interposing). *But we are writing it in the law?* (Emphasis supplied)

"Mr. Sullivan. *That is right.*" (Emphasis supplied)

In a similar manner, Mr. William S. Knudsen, then a member of the Advisory Commission to the Council of National Defense, testified (p. 159):

"If, at the end of the emergency, it turns out that plant facilities are useful for productive purposes during the emergency period only, the taxpayer is being only fairly dealt with by allowing him to charge off his plant against taxable income during the emergency period. If, however, the plant has productive use after the emergency period is terminated, there is no over-all advantage to the taxpayer in the rapid amortization because during the period after the emergency it will no longer be able to deduct depreciation or amortization on the plant, it having already been completely written off for tax purposes."

The substance of the testimony given by Mr. Sullivan and Mr. Knudsen was confirmed by John D. Biggers, Chairman of the Committee on Taxation and Finance, the Advisory Commission to the Council of National Defense, who testified (p. 169):

"Mr. Biggers. Yes, sir; as we see it, it is all a question of the rapidity of the depreciation. All facilities theoretically are depreciated against taxes during their life, and the Treasury and the Defense Commission agree that there is a probability that many of these facilities will enjoy a short life only.

"Senator Barkley. In the case I have illustrated, if the company were unable to absorb its new facility, or its expansion, in its ordinary peacetime business, the result would practically be a loss of the amount invested; would it not?

"Mr. Biggers. Yes; and therefore a company will not elect this option, will not proceed at its own risk under this tax incentive unless it feels reasonably sure that it can adapt or utilize its facilities after the emergency is over.

"Senator Clark. In that case, in the case stated by Senator Barkley, the company is simply gambling $850,000 against $150,000 on its judgment that this property will be valuable to them in their own business after the emergency, the 5-year period, is past. That is practically what they are doing.

"Mr. Biggers. Yes; that is true."

Implicit in the above testimony is the understanding on the part of Assistant Secretary of the Treasury Sullivan, Mr. Knudsen and Mr. Biggers that if the physical facilities were determined to be necessary in the interest of national defense, *ipso facto* their entire cost was includible in the "adjusted basis" and eligible for rapid tax amortization. In other words, it was agreed and understood that under Subsection (f)(1) of Section 124 Congress was conferring upon the certifying authority the *single power* to determine whether the physical assets listed in the taxpayer's application for a Certificate of Necessity were necessary in the interest of national defense.

It is only reasonable to conclude, based upon an examination of the House and Senate Reports, that Congress adopted *in toto* the views expressed by the various members of the Executive Branch of the Government who appeared before the Congressional Committee to urge the enactment of Section 124. See H. Rep. No. 2894, 76th Cong. 3d Sess., pp. 1-2, 16 (1940-2, Cum. Bull. 496, 507-508); S. Rep. No. 2114, 76th Cong. 3d Sess., pp. 8-9 (1940-2, Cum. Bull. 528, 534). For ex-

ample, in its report on the Second Revenue Act of 1940 the House Ways and Means Committee in its summary of Section 124 stated (H. Rep. No. 2894, 76th Cong. 3d Sess., p. 2 (1940-2 Cum. Bull. 496)):

> "Under the bill * * * a corporation is allowed a deduction for income and excess profits tax purposes for the amortization of * * * facilities which are certified by * * * either the Secretary of War or the Secretary of the Navy as necessary in the interest of national defense. *The write-off of the cost (adjusted basis for income tax purposes) of such facilities is permitted to be spread over a period of 60 months.*" (Emphasis supplied)

Nowhere in the Hearings and House and Senate Reports is there the slightest indication that either representative of the Treasury or members of Congress intended to grant the Secretaries of War and Navy, the then certifying authorities, the authority to determine that less than 100 percent of the cost of facilities certified to be necessary in the interest of national defense was includible in the "adjusted basis" and eligible for rapid tax amortization when, in his opinion, they possessed possible post-war utility. On the contrary, it is implicit in both said Reports that Congress merely intended to confer upon the certifying authority the power to determine whether the physical facilities were "necessary in the interest of national defense". In view of the wording of Subsection (f)(1) of Section 124 and its legislative history, the conclusion that the only power conferred on the Secretary thereunder was the single power to determine whether the facilities were "necessary in the interest of national defense" is, we submit, inescapable.

Strangely enough, cumulative support for taxpayer's position is to be found in the post-legislative history of

Section 124. The Korean emergency brought on a new defense production program, and with it in the Revenue Act of 1950 new amortization legislation. The new provision, incorporated into the 1939 Code as Section 124A (Appendix, *infra*) includes a Subsection (e)(1) which with one outstanding addition is substantially the same as Subsection (f)(1) of Section 124. Subsection (e)(1) of Section 124A provides:

> "(e) *Determination of Adjusted Basis of Emergency Facility.*—In determining, for the purposes of subsection (a) or subsection (g), the adjusted basis of an emergency facility—
>
> (1) There shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by executive order, has certified as necessary in the interest of national defense during the emergency period, *and only such portion of such amount as such authority has certified as attributable to defense purposes.* * * *" (Emphasis supplied)

Under Section 124A Congress granted to the certifying authority the dual power to determine (1) whether the facility was necessary in the interest of national defense, and (2) the portion or percentage of the cost of the facility attributable to defense. On the other hand, under Section 124 Congress refrained from conferring upon the certifying authority the power to make the latter determination. At least it did not expressly do so, and it did not, we submit, do so by implication.

The taxpayer does not mean to suggest that the post-legislative history of Section 124 is irrefutable proof that

Congress merely intended to grant the certifying authority the single power to determine whether facilities were necessary in the interest of national defense. Nonetheless, the taxpayer does take sharp issue with the Government's contention (Br. 46) that "if the post-legislative history proves anything, it indicates that Congress was only making explicit in the Korean War legislation what was implied in the World War II legislation". The taxpayer contends that if the post-war legislative history of Section 124 is of any evidentiary value, it indicates that it was correctly construed by the Court of Claims in the *Wickes Corp.*, *Ohio Power Co.*, and *Allen-Bradley Company* cases, and the Tax Court in the *National Lead Co.* case.

The Government evidences an attitude of horror and dismay over the effect of the interpretation the Court of Claims has given Section 124 in the instant case. In this connection, the Government states (Br. 34-35)—

> "Congress could scarcely have desired that certificates of necessity should represent blank checks, with the taxpayer entitled to amortize full costs of construction, no matter how much they exceeded the prior estimates contained in the application for the certificate. And where the proposed facility was designed to produce, in part, items of absolute necessity to the nation's defense and, in part, unnecessary civilian items, it is difficult to believe that Congress desired either that the entire cost of the plant should be certified or that no certificate should be issued, with the consequence that the necessary part of the production might be unavailable from privately owned plants."

The fallacies in the Government's argument are readily apparent. First, the certifying authority could and did refuse to certify as necessary facilities which were designed to produce unnecessary civilian items, whether the

facilities represented a building, machinery, or equipment.[6] Secondly, the certificates did not, as the Government suggests, represent "blank checks" because in order to be eligible for rapid tax amortization, the facilities were required to be within the scope of the original certification both as to description *and* as to cost.[7] The requirement that the facilities and their cost fall within the original certification prompted the filing of many an amended application for Certificates of Necessity. Finally, and possibly most important of all, it is clear that Congress was fully aware, indeed anticipated, that the facilities might possess post-war utility, but, the cost having been recovered through amortization deductions, any income arising from post-war use would not be reduced by normal depreciation of the cost of the facility. Congress felt that the defense of this country represented an important and over-riding consideration which justified the 100 percent or nothing approach to rapid amortization. As previously shown, ample support for that statement is contained in the testimony given by various representatives of the Executive Branch of the Government before the Senate Finance Committee on the Second Revenue Act of 1940.[8] And, as Representative Boehne,

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[6]As indicated in Footnote No. 2, part of the machinery and equipment listed in taxpayer's application for one of the three Necessity Certificates in question, Necessity Certificate NC-2631, was actually deleted by the certifying authority as not being necessary in the interest of national defense.

[7]On the application for a Certificate of Necessity the taxpayer was required to list not only the item which it wanted certified as necessary, but also its cost. After the item was constructed or acquired, the taxpayer had to furnish the certifying authority information with respect to its cost to determine whether it came within the scope of the original certification before the cost was includible in the "adjusted basis" and eligible for rapid tax amortization.

[8]See Senate Finance Committee Hearings on Second Revenue Act of 1940, 76th Cong. 3d Sess., Statements of John L. Sullivan (pp. 123-131); William S. Knudsen (pp. 157-166); John D. Biggers (pp. 166-186).

a member of the Ways and Means Committee and of its Subcommittee on Internal Revenue Taxation, said (Cong. Rec., Aug. 29, 1940, p. 11240):

> "Now just what do these amortization provisions do? First, they fix the useful life of facilities certified to be necessary in the national defense as 5 years. They remove all problems of proof.
>
> "Second, there is no bounty, bonus, or windfall involved. Introducing certainty into the present provision is a desirable improvement. It is designed to give the manufacturer, who is asked to furnish needed new facilities, only a fair break.
>
> "Finally, the effect of the clearing-up process is to give a straight-line basis—20 percent a year—* * *.
>
> "In the present national emergency, business is asking no favor of the Government when it merely desires the certainty that private capital expended to construct, or used to acquire, a needed new facility, certified to be necessary for the national defense, may under this law be amortized over a 5-year useful life, which is what business is being told is the present program. If the emergency lasts longer * * * no further deductions * * * will be allowed. The proposed amortization provisions will do no more than is fair and just. It will certainly aid national defense."

As has been demonstrated, the Government's contention that Section 124 conferred upon the certifying authority the power to certify that only a percentage of cost of facilities determined to be necessary was eligible for rapid tax amortization where the facilities, in the opinion of the certifying authority, possessed post-World War II utility, requires that the statutory words and phrases be given an unusual or tortured meaning unjustified by legislative intent. Under the circumstances, the Government's contention should not prevail. See *Better Business Bureau v. United States,* 326 U. S. 279, 281.

### D. The Graphite and Wickes cases.

In thrusting about for support for its position, the Government (Br. 29-34) places considerable emphasis upon Judge Pine's opinion in *United States Graphite Co. v. Harriman,* 71 F. Supp. 944 (D. C.), affirmed *per curiam,* (Judge Miller dissenting), *sub nom. United States Graphite Co. v. Sawyer,* 176 F. 2d 868, certiorari denied, 339 U. S. 904. With all due respect to Judge Pine and the Judges who agreed with him on appeal of the *Graphite* case, it is submitted that Judge Miller and the nineteen Judges who are in disagreement with him as to the interpretation to be given Section 124 (f) (1) are correct.[9] Furthermore, the Government has, for reasons which shall be explained, placed undue reliance on the *Graphite* case.

In the *Graphite* case, the taxpayer was a manufacturer of a product of "graphitar". In 1943 the demand for graphitar began to exceed the taxpayer's production capacity. On June 27, 1943 the taxpayer filed an application for a Certificate of Necessity under Section 124 in order to secure a deduction for amortization of the entire cost of a factory addition, and on October 28, 1943 a Necessity Certificate was granted therefor. On May 29, 1944 the taxpayer filed an application for a Necessity Certificate covering machinery to be used in the factory addition. Thereafter, the taxpayer was informed that the machinery was eligible for amortization only to the extent of 35 percent of its total cost. After making due demand for a 100 percent basis, the taxpayer filed a mandamus action in the District Court for the District of Co-

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[9]Most significantly, the dissenting opinion of Judge Miller in the *Graphite* case has won the approval of four Judges of the Court of Claims, and fifteen Judges of The Tax Court. See *Wickes Corp. v. United States, supra,* and *National Lead Co. v. Commissioner, supra.*

lumbia. In response, the Government filed a motion for summary judgment and it was granted. Admittedly, Judge Pine in his opinion indicated that under Section 124 (f) (1) the certifying authority had the power to determine that only a percentage of the total cost was includible in the "adjusted basis" for purpose of computing the amortization deduction. It is significant, however, that in denying mandamus Judge Pine said (p. 946):

> " * * * but in any event, defendant's construction being reasonable, it cannot be set aside by the courts in this proceeding.
>
> * * *
>
> Thus there is no showing that the exercise of this discretion comes within the exception permitting courts to intervene. *So far as its exercise involves interpretation of the statute * * * the statement made in the preceding paragraph is equally applicable.*" (Emphasis supplied)

The above indicates that all the *Graphite* case should be considered to stand for is that the Board's construction of Section 124 (f) (1) was not necessarily unreasonable so as to permit judicial interference by mandamus.[10]

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[10]As previously indicated, the decision of Judge Pine in the *Graphite* case was appealed to the Court of Appeals for the District of Columbia where it was affirmed by a divided court. In his dissent, Judge Miller analyzed Subsection (f) (1) of Section 124 as follows (p. 870):

> "In order to reach the extraordinary conclusion that subsection (f) (1) authorizes the certification as necessary to national defense of less than 100 percent of the cost of a facility otherwise 'emergency' in character, the appellee is forced to read subsection (f) (1) as though it provided:
>
> > 'There shall be included in amortizable cost only so much of the cost of the facility as * * * the Secretary * * * has certified as necessary in the interest of national defense * * *.'
>
> "Such reading omits important words in the subsection. It overlooks completely the fact that its language includes the following: ' * * * as is properly attributable to such construction * * * after December 31, 1939, as * * * the Secretary * * *

It is interesting to note that the United States Graphite Company was subsequently merged into the Wickes Corp., and under that name an action was brought in the Court of Claims for tax refund upon the same contention, with success, that had been made before the merger upon the United States Graphite Company's application for mandamus. See *Wickes Corp. v. United States, supra.* In the *Wickes* case, the Government, quite properly, did not plead *res judicata,* because the only question in the *Graphite* case was whether the certifying authority's construction of Section 124 (f) (1) was "reasonably possible", whereas the issue in the *Wickes* case was whether it was correct.

In the *Wickes* case, as in the instant case, the certifying authority certified the facilities as being necessary, and

> has certified as necessary in the interest of national defense * * *.'
>
> "The appellee's construction of subsection (f) (1) as meaning 'only so much of the cost as has been certified as necessary in the interest of national defense' does plain violence to the grammatical structure of the statutory sentence, for, as has been said, it leaves out important words. Careful reading of the poorly worded subsection reveals its meaning as
>
> "There shall be included as amortizable cost only so much of the cost of the facility as is properly attributable to the part of it which was constructed after December 31, 1939, and which has been certified as necessary in the interest of national defense.
>
> "We have seen that subsection (e), in defining the term 'emergency facility', expressly excluded anything constructed or acquired before December 31, 1939. That critical date of subsection (e) was carried on into subsection (f) (1), which undertook to govern a situation involving a facility, a part of which was constructed before December 31, 1939, and so could not be amortized, and the other part of which was constructed after that date and so could be certified for amortization. * * * I think subsection (f) (1) clearly means there can be amortized only the 'adjusted basis' (which in this case means cost) of that physical portion of a facility which is 'emergency' in character in that (a) it had been constructed after December 31, 1939, and (b) it had been properly certified as necessary in the interest of national defense."

then proceeded to issue a Necessity Certificate certifying that only a certain percent of their total cost was eligible for rapid amortization. Commenting on the certifying authority's refusal to certify 100 percent of the cost as being eligible for rapid amortization, and the Regulations upon which the refusal was predicated (8 Fed. Reg. 2492, March 4, 1944), the Court of Claims said (p. 621):

> "His refusal, therefore, amounted in law, though not in fact, to an arbitrary refusal to perform his statutory duty. We have no reason to suppose that the enormous tax benefits which Congress, wisely or not, sought to confer by the enactment of Section 124 were to be bestowed or withheld at the arbitrary will of the executive. Equity regards that as done which ought to have been done. We do not have here the problem of deciding, contrary to the decision of the official in which the statute lodged the power of decision, that the facilities in question were necessary. He decided that they were. We merely append the proper legal consequences to his decision by disregarding the invalid regulation which prevented him from putting his factual decision in legal form. We conclude, therefore, that the facilities acquired by the plaintiff before July 17, 1944, were eligible for accelerated amortization, and that the plaintiff is entitled to that amortization."

## II.

**The Government Is Barred From Raising The Issue Of Whether The Taxpayer Failed To Timely Challenge The Certifying Authority's Lack Of Power To Determine That Only A Percentage Of The Total Cost Of The Facilities Certified As Necessary In The Interest Of National Defense Was Includible In The "Adjusted Basis" For Purposes Of Computing The Amortization Deduction Permitted Under Section 124 Of The 1939 Code.**

The Government contends that the taxpayer has failed to timely challenge the certifying authority's lack of power to certify that less than 100 percent of the cost of facilities certified as being necessary in the three Certificates of Necessity, subject of dispute, was includible in the "adjusted basis" for purposes of computing the amortization deduction permitted under Section 124 of the 1939 Code. It claims that having proceeded under the Certificates as issued, the taxpayer is estopped to later challenge the percentage determination. Nowhere in the Answer (R. 11-12) filed in response to the taxpayer's Petition filed in the court below, or, for that matter, nowhere in the proceeding in the court below did the Government raise this defense. Indeed, the first time the Government raised this defense was in its petition for a writ of certiorari (p. 5-11).

The taxpayer submits that having failed to assert this defense in the proceedings before the Court of Claims, the Government is precluded from asserting it for the first time in this Court. Waiver, estoppel, and collateral attack are defenses to be pleaded affirmatively. Paragraph (b) of Rule 15 of the Rules of the United States

Court of Claims (revised to October 15, 1953)[11] entitled "Defenses" provides—

> "(b) *Affirmative Defenses:* In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, duress, estoppel, failure of consideration, fraud, illegality, laches, license, payment, release, res judicata, statute of limitations, waiver, and any other matter constituting an avoidance or affirmative defense. When a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the Court may, if justice so requires, treat the pleading as if there had been a proper designation."

See also *National Nickel Co. v. Nevada Nickel Syndicate,* 112 Fed. 44 (C. A. 9th) certiorari denied, 184 U. S. 700; *Kelly v. Commissioner,* 228 F. 2d 512 (C. A. 7th); *Collins v. Commissioner,* 18 T. C. 99, aff'd. 203 F. 2d 565 (C. A. 6th); *Carnegie Center Co. v. Commissioner,* 22 T. C. 1189. Under Rule 18 of the Rules of the United States Court of Claims, the Government had ample opportunity to amend its Answer but failed to avail itself of the privilege to do so.

The Government is in effect requesting this Court to disregard well established rules of civil procedure in considering this case. If litigants could raise for the first time on appeal affirmative defenses not pleaded in the court of original jurisdiction, it would merely serve to further burden our already over-burdened Federal Court system. Under the circumstances, it would hardly be appropriate for this Court to consider a defense raised for the first time in a petition for a writ of certiorari. Indeed, the fact that the Government should so suggest

[11]Paragraph (b) of Rule 15 of the Rules of the United States Court of Claims and Paragraph (c) of Rule 8 of the Federal Rules of Procedure (as amended through September 1, 1949) are identical.

is, we believe, almost ludicrous, particularly when there is a civil, as opposed to a criminal, case involved.

This is not the first time the Government has attempted to raise an entirely new and different defense on appeal. In *General Utilities Co. v. Helvering,* 296 U. S. 200, 209, this Court, reversing a reversal of the Board of Tax Appeals, said:

> "The second ground of objection, although sustained by the Court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point, and, in the circumstances, we think the Court should have considered no others. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him."

In *Helvering v. Salvage,* 297 U. S. 106, the Commissioner of Internal Revenue first asserted estoppel as a defense in the Circuit Court of Appeals. The Commissioner had failed to assert it in the proceeding before the Board of Tax Appeals, and it was neither presented nor considered. This Court, citing as authority its decision in the *General Utilities Co.* case, held that because of the Commissioner's failure to plead estoppel in the proceeding before the Board of Tax Appeals, it could not be considered on appeal as a defense. See also *Platt v. Commissioner,* 207 F. 2d 697 (C. A. 7th).

In this instance, the Government failed to plead in the Court of Claims that the taxpayer was barred by laches or other similar defenses from challenging the certifying authority's power to determine that less than 100 percent of the cost of facilities certified as necessary in the interest of national defense were includible in the "adjusted basis" and eligible for rapid amortization under Section 124. Under general rules of pleading and the rationale of the decisions of this Court in the *General Utilities Co.*

and *Salvage* cases, this issue has not been properly raised so as to permit its consideration by this Court.

## CONCLUSION

For the foregoing reasons the judgment of the Court of Claims should be affirmed.

*Respectfully submitted,*

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November, 1956.

## APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(t) (as added by Sec. 301, Second Revenue Act of 1940, c. 757, 54 Stat. 974) *Amortization Deductions.*—The deduction for amortization provided in section 124. (26 U. S. C., 1952 ed., Sec. 23.)

SEC. 124 (as added by Sec. 302, Second Revenue Act of 1940, *supra*). AMORTIZATION DEDUCTION.

(a) (as amended by Sec. 155(a), Revenue Act of 1942, c. 619, 56 Stat..798) *General Rule.*—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (e)), based on a period of sixty months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (g) of this section, be in lieu of the deduction with respect to such facility for such month provided by section 23(1), relating to exhaustion, wear and tear, and obsolescence. The sixty-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

* * * *

(d) *Termination of Amortization Period.*—

(1) If the President has proclaimed the ending of the emergency period (as defined in subsection (e)), or if the Secretary of War or the Secretary of the Navy has, in accordance with regulations prescribed by the President, certified to the Commissioner that an emergency facility ceased, on the date specified in the certificate, to be necessary in the interest of national defense during the emergency period, and if the date of such proclamation or the date specified in such certificate occurs within sixty months from the beginning of the amortization period with respect to such emergency facility, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the sixty-month period.

* * * *

(e)[1] (as amended by Sec. 155(d) of the Revenue Act of 1942, *supra*) *Definitions.*—

(1) *Emergency facility.*—As used in this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made. For

[1]As originally enacted, subsection (e)(1) provided:

(e) *Definitions.*—

(1) *Emergency facility.*—As used in this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, or installation of which was completed after June 10, 1940, or which was acquired after such date, and with respect to which a certificate under subsection (f) has been made.

the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by any person after December 31, 1939, and not earlier than six months prior to the filing of an application for a certificate under subsection (f), and with respect to which part a certificate under subsection (f) has been made, shall be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than six months prior to the filing of such application. For the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by a corporation after December 31, 1939, and before June 11, 1940, and with respect to which part a certificate under subsection (f) has been made, shall be deemed to be an emergency facility and to have been completed on June 10, 1940, notwithstanding that the entire facility was not completed until after June 10, 1940.

* * * *

(f) (as amended by Sec. 155(e) of the Revenue Act of 1942, *supra*) *Determination of Adjusted Basis of Emergency Facility.*—In determining, for the purposes of subsection (a) or subsection (h), the adjusted basis of an emergency facility—

(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President.

(g) *Depreciation Deduction.*—If the adjusted basis of the emergency facility computed without

regard to subsection (f) of this section is in excess of the adjusted basis computed under such subsection, the deduction provided by section 23(l) shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis were an amount equal to the amount of such excess.

* * * *

(26 U. S. C. 1952 ed., Sec. 124.)

SEC. 124A (as added by Sec. 216(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906). AMORTIZATION DEDUCTION.

* * * *

(e) *Determination of Adjusted Basis of Emergency Facility.*—In determining, for the purposes of subsection (a) or subsection (g), the adjusted basis of an emergency facility—

(1) There shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by Executive order, has certified as necessary in the interest of national defense during the emergency period, and only such portion of such amount as such authority has certified as attributable to defense purposes. Such certification shall be under such regulations as may be prescribed from time to time by such certifying authority with the approval of the President. An application for a certificate must be filed at such time and in such manner as may be prescribed by such certifying authority under such regulations but in no event shall such certificate have any effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, or before the expiration of six months after the date of

enactment of the Revenue Act of 1950, whichever is later.

* * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.124-6 (as amended by T. D. 5432, 1945 Cum. Bull. 180). *Adjusted basis of emergency facility.*—

(a) *In general.*—The adjusted basis of an emergency facility for purposes of computing the amortization deduction may differ from what would otherwise constitute the adjusted basis of such emergency facility, in that it shall be the adjusted basis for determining gain (see section 113) and in that it may be only a portion of what would otherwise constitute the adjusted basis. It will be only a portion of such other adjusted basis if only a portion of the basis (unadjusted) is attributable to the certified construction, reconstruction, erection, installation, or acquisition after December 31, 1939. It is therefore necessary first to determine the unadjusted basis of the emergency facility from which the adjusted basis for amortization purposes is derived.

The unadjusted basis for amortization purposes, in cases where the entire construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1939, and such construction, reconstruction, erection, installation, or acquisition is certified in its entirety by the certifying officer as necessary in the interest of national defense during the emergency period, is the same as the unadjusted basis otherwise determined.

In cases where the certifying officer certifies the entire construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as necessary in the interest of national defense during the emergency period, but only a portion of the con-

struction, reconstruction, erection, installation, or acquisition attributable to the facility takes place after December 31, 1939, the unadjusted basis for the purposes of amortization is so much of the entire unadjusted basis as is attributable to that portion of the construction, reconstruction, erection, installation, or acquisition which took place after December 31, 1939. For example, the X Corporation begins the construction of a facility November 15, 1939, and such facility is completed on April 1, 1940, at a cost of $500,000, of which $300,000 is attributable to construction after December 31, 1939. The certificate of necessity covers the entire construction after December 31, 1939, and the unadjusted basis of the emergency facility for amortization purposes is therefore $300,000. For depreciation of the remaining portion of the cost ($200,000), see section 29.124-7.

If the certifying officer certifies only a portion of the construction, reconstruction, erection, installation, or acquisition after December 31, 1939, then the unadjusted basis for amortization purposes is limited to the amount attributable to such portion of the construction, reconstruction, erection, installation, or acquisition after December 31, 1939. Assuming the same facts as in the example in the preceding paragraph, except that the certificate is to the effect that only 50 percent of the construction after December 31, 1939, is necessary in the interest of national defense during the emergency period, the unadjusted basis for amortization purposes is 50 percent of $300,000, or $150,000.

* * * *